Supreme Court, U.S.
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No.

IN THE

SUPREME COURT OF THE UNITED STATES

JOHN H. MINER and HOLLY K. MINER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for A Writ of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

I. Is a shareholder of an "S" corporation entitled to deduct a portion of the purchase price paid a former shareholder for his stock interest for an oral covenant not to compete and have such question determined on the basis of realties and the substance of the transaction?

LIST OF PARTIES AND RULE 29.6 LIST

The parties to the proceedings in the Court of Appeals for the Ninth Circuit and the United States Tax Court were the Taxpayers, John H. and Holly K. Miner (Petitioner/Appellants) and the Commissioner (Respondent/Appellee). Indirectly involved was a Subchapter "S" corporation, Cost Less Auto Parts, Inc. (hereafter "Cost Less"). There is no parent corporation or publicly held corporation owning 10% or more of Cost Less' capital stock.

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PETITION FOR A WRIT OF CERTIORARI

The Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

CITATIONS OF OFFICIAL AND UNOFFICIAL REPORTS, OPINIONS AND ORDERS IN THE LOWER COURT

John H. Miner & Holly K. Miner, Petitioners-Appellants v. Commissioner of Internal Revenue, Respondent-Appellee, United States Court of Appeals for the Ninth Circuit, No. 00-70625, Tax Court No. 21663-96, Memorandum Filed November 7, 2001. The opinion is reproduced in the Appendix at pages 1 through 3.

John H. Miner; Holly K. Miner, Petitioners v. Commissioner of Internal Revenue, Respondent, United States Court of Appeals For The Ninth Circuit, No. 00-70625, CT/AG#: 21663-96 Judgement dated November 7, 2001. The decree is reproduced in the Appendix at pages 3 through 4.

John H. Miner and Holly K. Miner, Petitioners v. Commissioner of Internal Revenue, T. C. Memo 1999-358 (October 26, 1999). The opinion is reproduced in the appendix at pages 4 through 22.

John H. Miner and Holly K. Miner, Petitioners v.

Commissioner of Internal Revenue, Docket No. 21663-96, Decision of United States Tax Court, dated March 7, 2000. The decision is reproduced in the Appendix at pages 22 through 23.

JURISDICTION

This case arises under the Internal Revenue laws of the United States and jurisdiction of the Court is vested by Article III, Section 2 of the Constitution of the United States and Title 28, United States Code, Sec. 1254 which provides:

> "Court of Appeals; certiorari; certified question. Case in the courts of appeal may be reviewed by the Supreme Court by the following methods:
>
> (i) By writ of certiorari granted upon petition of any party to any civil or criminal case, before or after rendition of judgment or Decree";

The date the judgment or decree sought to be reviewed was entered November 7, 2001 (App. pp. 3-4) and the statutory provision believed to confer jurisdiction on this Court to review on a writ of certiorari the judgment or decree in question is 28 U.S.C. §1254.

STATUTES INVOLVED

The constitutional provisions, statutes and Internal Revenue regulations are:

Section 167, Internal Revenue Code;

Section 169, Internal Revenue Code;

Treasury Regulation 167(a)(3), which provides in pertinent part:

> . . . If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be subject to a depreciation allowance . . .

STATEMENT OF THE CASE

Petitioners petitioned the Tax Court of the United States for a redetermination of deficiencies in their income taxes for 1988, 1989 and 1991. The Tax Court acquired subject matter jurisdiction pursuant to Section 6213, Internal Revenue Code of 1986 (hereafter "IRC"). See also Sec. 7442, IRC.

From an adverse decision by the Tax Court entered March 7, 2000 (App. pp. 22-23), which was a final decision within the meaning of Sec. 7481, IRC., Petitioners filed a timely Notice of Appeal to the United States Court of Appeals for the Ninth Circuit, appealing that part of the Tax Court's Opinion promulgated October 3, 2000 (App. pp. 4-22) and the Decision entered March 7, 2000, relating to the covenant not to compete involved in the case. The Ninth Circuit had exclusive jurisdiction to review the

Decision of the Tax Court pursuant to Sec. 7482, IRC. On November 7, 2001, the Ninth Circuit Court of Appeals filed its Memorandum Opinion (App. pp. 1-3) and Decision (App. pp. 3-4) affirming the Tax Court.

The covenant not to compete arose from the sale of stock of Cost Less by Leonard Jasiak to Petitioner. Cost Less was a Subchapter "S" corporation and Jasiak and Petitioner each owned 50% of the stock of the corporation. Both participated in its management.

Cost Less was incorporated in 1974 and engaged in the business of selling new and used auto parts in Tucson, Arizona. Its business was highly competitive with over 30 competitors within a five-mile radius of the Cost Less store and 90 within Tucson.

In 1986, Jasiak told Miner he wanted to retire. The book value of the company at the time was low and petitioner talked about book value as a purchase price for Jasiak's 50% stock interest. Jasiak was not interested in that but they finally agreed upon $175,000 as the figure.

In the negotiations between them, one of the concerns Petitioner had was that he did not want Jasiak to retire from the business and thereafter compete with Cost Less. While Cost Less engaged in business, Jasiak started another auto parts store in competition with Cost Less without Petitioner or ever having discussed it with him. Petitioner did not want that to happen again. He was aware how competitive the business was and did not want to pay Jasiak a large sum of money without a covenant not to compete. Without a covenant, he would not have agreed to purchase Jasiak's stock.

They both used the same attorney who prepared

the original draft of a proposed agreement between them which contained a written covenant not to compete. Upon review of the draft, Jasiak was insulted and incensed that the draft contained the covenant. He felt he had given his word to Petitioner that he would not compete and that his word should be good enough. Finally, Jasiak agreed to give Cost Less an oral covenant that he would not compete with Cost Less for a period of seven (7) years in Tucson and Pima County and that the covenant could be considered a part of the transaction. However, he reiterated he would not sign an agreement with the covenant in it.

Because of Jasiak's objection, the covenant was removed from the final agreement. Based upon his oral covenant, Cost Less entered into an agreement on December 24, 1986 to acquire Jasiak's stock for $175,000 with $50,000 down and the balance in equal monthly installments until paid in full. (App. 24-34) The purchase agreement was performed in full and payment was completed in seven (7) years. Also, Jasiak complied with his oral covenant not to compete with Cost Less over the seven (7) year period.

/ The original corporate income tax returns of Cost Less (Form 1120S) were prepared without a deduction for the covenant. After they had been filed, Petitioner went to the corporation's present accountant who reviewed the transaction. Petitioner told him Jasiak had given him an oral covenant in connection with the stock purchase transaction and that the corporation's attorney was present when the covenant was given. The accountant reviewed the agreement, obtained a letter from the attorney that

Jasiak had given an oral covenant and concluded that the corporation should amortize the covenant at $25,000 per year over the seven (7) year life. At December 31, 1986, the book value of the capital stock of Cost Less was $9,773.

Respondent disallowed the deduction claimed by Cost Less for the covenant not to compete and adjusted Petitioner's Subchapter "S" distribution from it accordingly.

REASONS FOR GRANTING THE WRIT

I.

THE COURT SHOULD GRANT THE WRIT TO EXERCISE ITS SUPERVISORY POWERS TO ESTABLISH CONSISTENT RULES UPON WHICH THE DEDUCTION FOR THE COVENANT NOT TO COMPETE MAY BE ALLOWED OR DISALLOWED, AND TO ELIMINATE THE CONFUSION EXISTING IN THE LOWER COURTS.

Petitioner maintains the decided cases of the court of appeal in the area of the "covenant not to compete" is so convoluted and diverse as "to call for an exercise of the Court's supervisory power" in order to overcome existing confusion. Rule 10, U.S. Sup.Ct. Rules. While amortization of intangibles is permitted by Sec. 167, IRC, *Network Morning Ledger,* 507 U.S. 546 (1993); *Treasury Reg.* 167 (a)-3, amortization of the covenant not to compete has produced case law with varying results leaving the taxpayer's pathway

hazardous and without direction. It is the "legal standard required to be applied" in these cases which is of concern to Petitioner. *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

In *Wilson Athletic Goods Mfg. v. Com. of Int. Rev.* 222 F.2d 355 (CA7, 1955) the Commissioner refused to allocate a part of the purchase price of an athletic shoe company as a covenant not to compete by the taxpayer. The Tax Court had sustained the Commissioner finding that the value of the covenant could not be segregated from the gross price paid for the business. Although the sellers of the business had covenanted in the contract they would not compete for a designated period, no allocation of any portion of the purchase price was made to the covenant. The Seventh Circuit, upon reviewing the evidence, cited a litany of business reasons why the taxpayer had requested the covenant, one of which was it would not have acquired the business without the consent. In reversing the Tax Court, it said:

> The tax court seemed to think that, in order to justify treating the covenant as an intangible capital asset, the contract must have provided an express segregation of the $132,000 from the total purchase price as the value of the covenant. But in tax matters we are not bound by the strict terms of the agreement; we must examine the circumstances to determine the actualities and may sustain or disregard the effect of a written

provision or of an omission of a provision, if to do so best serves the purposes of the tax statute. *Higgins v. Smith*, 308 U.S. 473 at page 477, 60 S.Ct. 355, 84 L.Ed. 406. The incidence of taxation depends upon the substance of the transaction. Tax consequences are not to be finally determined solely by the mechanical means employed to transfer legal title. We must look to the realities. *Hamlin's Trust v. Commissioner,* 10 Cir., 209 F.2d 761, at page 764; *Commissioner of Internal Revenue v. Court Holding Co.,* 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981; *Jones v. Grinnell,* 10 Cir., 179 F.2d 873. Therefore, it was the duty of the tax court and is our duty here to ascertain the true intent, insofar as tax consequences are concerned. Consequently, it is immaterial whether the contract did or did not define a specified amount as the value of the covenant . . . Where realistically and actually the covenant has a discernible value, the purchaser, of course, may amortize the price paid for it and claim annual deductions pro rata during the life of the covenant. *Commissioner of Internal Revenue v. Gazette Tel. Co.,*

> 10 Cir., 209 F.2d 926, at page 928. We conclude that the record justifies only a finding that the value of the covenant not to compete was the sum of $132,692.30, and that the tax court erred in not so finding.

It is clear the *Wilson* Court determined it was essential to take into consideration the business reasons and exigencies surrounding the transaction to determine the value of the covenant where the value had been omitted.

Conversely, the Third Circuit in *Com. Int. Rev. v. Danielson*, 378 F.2d 771 (CA3, 1967) applied a rule of strict construction to the contract containing the covenant, adopting as a rule of law:

> . . . a party can challenge the tax consequences of his agreement as construed by the Commissioner only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.

In adopting this rule, it reviewed and distinguished prior decided cases of its own circuit, *Mathews v. Com. Int. Rev.*, 311 F.2d 795 (CA3, 1963), affirming the Tax Court's finding "the covenant had independent substance which could be equated to the covenant"; and *Levine v. Com. Int. Rev.*, 324 F.2d 298 (CA3, 1963) which affirmed the Tax Court's allocation

of value of the covenant different from that expressed by the parties in their agreement, on grounds of the rule advanced in *Mathews*, supra. It also reviewed the opinions of other circuits, including *Ullman v. Com. Int. Rev.*, 264 F.2d 305 (CA2, 1959), affirming the Tax Court which applied the rule that "strong proof" must be adduced to overcome assigned value given to the covenants in the contract as supporting its pronouncement, citing *Balthrope v. Com. Int. Rev.*, 356 F.2d 28 (CA5, 1966); *Montesi v. Com. Int. Rev.*,340 F.2d 97 (Ca6, 1965) and *Hamlin's Trust v. Com. Int. Rev.*, 209 F.2d 761 (CA10, 1954) as supportive of its position. However, a vigorous dissent rebuked the majority position by holding it had adopted an "arbitrary rule of exclusion to be applied in tax cases" which disregarded a long line of decisions of this court to the contrary. See *Eisner v. Macomber*, 252 U.S. 189 (1919) ("income tax cases should be decided according to truth and substance, without regard to form") Id. at 206; *Weiss v. Stern*, 265 U.S. 242 (1924) (income taxation to be determined by viewing what was done, rather than to declare purpose of the participants, i.e. substance and not mere form).

In the Ninth Circuit there are two cases of significance. *Schulz v. Com. Int. Rev.*, 294 F.2d 52 (CA9, 1961) and *Annabelle Candy v. Com. Int. Rev.*, 314 F.2d 1 (1962). In *Schulz* the Court approved the Commissioner in proper cases of going beyond the dealings of the parties to determine substance over form, citing *Com. Int. Rev. v. Court Holding Co.*, 324 U.S. 331 (1945) and *Gregory v. Helvering*, 293 U.S. 446 (1935).

In *Annabelle Candy Co.*, the Ninth Circuit had

before it an agreement containing a covenant to which no consideration had been assigned. The taxpayer, *Annabelle Candy*, had allocated the difference between its earned surplus and the sales price as being applicable to the covenant. The Commissioner disallowed deduction based upon such allocation. The Tax Court sustained the Commissioner. The Ninth Circuit, however, reversed and remanded the case back to the Tax Court, quoting approvingly of the reasoning of the Seventh Circuit in *Wilson*, supra.

A. The Petitioner, a shareholder of Cost Less, an "S" corporation, is entitled to deduct a portion of the purchase price paid a former shareholder for an oral covenant not to compete and both the Tax Court and the Ninth Circuit erred in failing to allocate an amount to the covenant.

If the reasoning of the Seventh Circuit in *Wilson* was uniformly followed by the Court of Appeals, clarity in allocation of consideration to covenants not to compete would exist. However, the Ninth Circuit failed to follow its own teachings in *Annabelle Candy:*

The fact that a preliminary purchase price had been agreed upon before the parties began discussing restrictive covenants does not necessarily preclude such covenants from being of value; nor does it preclude the court from allocating a value–a portion of the total contract price–to such covenant when no specific allocation is made by the parties in the contract. We think the reasoning of the court in *Wilson Athletic Goods Mfg. Co. v. Commissioner*, 7 Cir., 1955, 222 F.2d 355, particularly at 456-457, here controls.

While determination of the issue may not be easy, the Tax Court recognized in *Standard Lumber and Hardware Company, Memorandum Decision* 23, 149, T.C. Memo 1958-159 (Aug. 26, 1958) the existence of an oral covenant not to compete and allocated a part of the purchase price paid a retiring partner for amortization. Both the Tax Court and the Ninth Circuit, under existing case law, had judicial responsibility to make that finding and ultimate conclusion. "The one sure way to do injustice is to allow nothing whatever upon excuse that we cannot tell how much to allow." *Commissioner v. Maresi,* 156 F.2D 929 (CA2, 1946).

Petitioners assert it is clear an oral covenant was given by Jasiak. The failure to allocate value to it should not be indicative that none was intended. What needed to be done in this case was a determination whether the covenant was severable from good will, if any, and it had "economic reality" from which it could be concluded one would bargain for it. *Patterson v. Commissioner,* 510 F.2d 562, 571 (CA6, 1987) affing T.C. Memo 1985-53; *Schultz v. Commissioner,* supra. If the covenant is severable from good will and has "economic reality," whatever value assigned to it is amortizable. *O'Dell,* 61 T.C. 461 (1974); *Aron Michaels,* 12 T.C. 17 (1949); *B.T. Babbitt,* 32 BTA 693 (1935).

Petitioner's case was presented to the Tax Court as virtually on all fours with *Standard Lumber,* supra. In that case, there were four partners with equal capital positions. A dispute arose between two resulting in an offer of one to buy the other for $70,000 and a covenant not to compete. None of the

documentation contained a reference to the covenant, and a deduction was not made by the partnership or its successor corporation for amortization of the covenant until amended returns for the acquiring partners were filed.

After disallowance of the amortization deduction, based upon $32,587.22 being allocated to the covenant, the taxpayer petitioned the Tax Court which found the covenant was in fact given and that its value was the difference between the book value of the partner's interest and the price paid for it. The Tax Court concluded there had to be some explanation for the taxpayer to pay $37,412.78 in excess of the agreed upon book value for the interest and "the most logical explanation in this record is that it was paid for his agreement not to compete." While the Court did not cite *Wilson Athletic Goods*, supra, it appears obvious that the Tax Court judge looked to the substance of the transaction and not to its form.

B. The similarities in this case with Standard Lumber are striking.

1. Both parties were adversarial. Both, the surviving partner in *Standard Lumber* and Petitioner in this case, insisted on the covenant. Petitioner had experienced Jasiak starting another auto parts store in competition with Cost Less and he was concerned about that happening again. He would not have purchased Jasiak's stock without the covenant as he knew the business "forwards and backwards" and Petitioner did not believe there was room for both of them in the business.

2. The covenants in both cases were oral. In *Standard Lumber* the selling partner wanted "the

agreement to be on their word alone." In this case, Jasiak was insulted when the attorney put the covenant in the agreement, and insisted it be oral and outside of the agreement. The covenant was separately bargained for by Petitioner and thus possessed economic reality.

3. Reference was made to book value when transaction negotiated. In both cases, reference was made to book value. Such was set forth in the partnership agreement in *Standard Lumber* and arose in direct negotiations with Jasiak. Moreover, the small book value demonstrates a lack of good will for the stock as each party prior to the transaction was withdrawing corporate profits as "S" distributions. With the low book value in the instant case, i.e. $9,973, taxpayer paid virtually $165,000 in excess of book value for the stock as of the closing date. The most logical explanation for that is that it was paid for the covenant. It is unjust and unreasonable to conclude the covenant had no value. It was the greatest ting of value received by Petitioner on the closing.

4. Neither parties claimed a deduction for amortization until they changed accountants. This fact reveals the economic reality to the covenant. It was a necessary and needed part for both parties.

5. The value and life of the covenant. The fact is that Jasiak did not thereafter compete with Cost Less. Thus, the oral covenant had economic value to Petitioner. Since the parties did not determine value, it should be determined by the court as in *Standard Lumber*. See *Wilson Athletic Mfg. Co. v. Commissioner*, supra; *Levine v. Commissioner*, supra.

Such value may be determined by the court under the principle of *Cohan v. Commissioner,* 39 F.2d 540 (CA2, 1930). Petitioners contend the difference between the book value and the purchase price is a starting point for value determination of the covenant.

CONCLUSION

The Tax Court found that Petitioner was not entitled to amortize any portion of the payment of $175,000 to Jasiak because Petitioner and Jasiak did not intend to allocate any of the payment to the promise and Petitioner has not proven Jasiak's promise had value. It did indeed find that the oral covenant was given by Jasiak, however, it failed to look at realities and following the teachings of the Seventh Circuit in *Wilson Athletic Goods,* supra, that it is immaterial whether the parties did or did not determine a specified amount as to the value of the covenant. Instead, it threw another block in the Petitioner's pathway, that of proving fair market value of a 50% interest in a closely held Subchapter "S" corporation.

The Ninth Circuit on the other hand gave little, if any, credence to the credibility of the Petitioner's position. It held that the Tax Court trial judge was entitled to "deference." But then, every taxpayer is entitled to deference; entitled to know the pathway of proof to follow; and entitled to have the court look at the realities of his case to determine true intent, recognizing tax consequences are determined by actualities, that the effect of a written provision or the

omission of it is not necessarily controlling and ultimately determine the substance of the transaction. Respectfully, until this Court exercises its Rule 10 supervisory power, Petitioners fear that will not be forthcoming uniformly from the circuit courts of appeal.

Therefore, it is requested this Petition be granted.

Respectfully submitted,

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NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN H. & HOLLY K. MINER,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE
Respondent-Appellee.

No. 00-70625
Tax Court No. 21663-96

MEMORANDUM[1]

Appeal from the United States Tax Court
John O. Colvin, Tax Judge, Presiding
Argued and Submitted October 16, 2001
San Francisco, California
Before: SNEED, TROTT, and TALLMAN, Circuit Judges.

This case, an appeal from the Tax Court, concerns the proper income tax treatment of proceeds from the sale of stock by Leonard Jasiak to Appellants Holly and John Miner. Miner and Jasiak were the sole shareholders of Cost Less Auto Parts, Inc. ("Cost Less"), a Subchapter S corporation. Both participated in the management of the corporation and each owned 50% of the stock of the corporation.

Jasiak decided to retire in 1986 and sold his stock to Cost Less for $175,000, $50,000 paid at closing and the balance by a promissory note. The agreement did not contain a covenant not to compete; it stated that it was to

1 This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as may be provided by Ninth Circuit Rule 36-3.

be governed by Arizona law; and it contained a merger clause.

Despite the agreement's failure to contain a written covenant not to compete by Jasiak, Appellants Holly and John Miner amortized the entire $175,000 purchase price over a seven-year period on the basis that it constituted the amount paid to obtain Jasiak's oral promise not to compete.

This case involves the alleged deficiencies arising from the taxable years 1988, 1989, and 1991, in the amounts of $13,717. $8,428 and $14,586, respectively, each arising from the Miners' efforts to amortize a portion of the $175,000 paid to Jasiak. To repeat, at no time was there a written agreement between Jasiak and the Miners apportioning any part of the purchase price to a covenant not to compete by Jasiak.

Following cross-motions for summary judgment, the Tax Court held that there was "no credible evidence that the parties intended to allocate any of the $175,000 to Jasiak's promise not to compete." Thus, it held, "Cost Less may not amortize any amount for Jasiak's oral promise not to compete because the parties did not allocate or intend to allocate any amount to it. Tax Court Opinion at 10-12.

The Tax Court's factual findings support this conclusion. These include: (1) the absence of any specific apportionment of the purchase price to the oral covenant not to compete; (2) the absence of any covenant not to compete in the written agreement; (3) the unconvincing nature of attempts by the taxpayer to establish a book value of Jasiak's stock at $10,000 and the balance of the purchase price to good will and oral covenant; and, (4) Miner's own testimony that there was not allocation of a portion of the purchase price to goodwill.

The record supports these factual findings.

Moreover, the Tax Court's finding that Jasiak's testimony was more credible than Miner's is entitled to strong deference. It is not clearly erroneous. It follows that the stock purchase agreement does not provide a proper basis for the allocation of any portion of the purchase price to the covenant not to compete. Where a stock purchase agreement is silent as to allocation of a specific percentage of the purchase price to a covenant not to compete, a buyer can amortize a portion of the purchase price if the parties "*intend[ed]* to allocate a portion of the purchase price to the covenant not to compete." See Annabelle Candy Co. v. C.I.R., 314 F.2d 1, 8 (9th Cir. 1962) (emphasis original). The Tax Court's denial of a deduction by Appellants of any portion of the purchase price of Jasiak's stock was therefore proper.

AFFIRMED.

Filed and entered November 7, 2001.

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

- - - - - - - - - - - - - - -

NO. 00-70625
CT/AG#: 21663-96

JOHN H. MINER; HOLLY K. MINER
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent

Upon Petition to Review a Decision of The Commissioner of Internal Revenue.

THIS CAUSE came on to be heard on the Transcript

of the Record from the Commissioner of Internal Revenue and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the Appeal Decision of the said in this cause be, and hereby is AFFIRMED. (sic)

Filed and entered November 7, 2001.

T. C. Memo. 1999-358
UNITED STATES TAX COURT

JOHN H. MINER AND HOLLY K. MINER, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 21663-96 Filed October 26, 1999.

Hubert E. Kelly, for petitioners.

John W. Duncan, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COLVIN, Judge: Respondent determined deficiencies in petitioners' income tax and additions to tax as follows:

		Additions to tax			Penalty
		Sec.	Sec.	Sec.	Sec.
Year	Deficiency	651(a)(1)	6653(a)(1)	6654	6662 (a)
1988	$13,717	$3,207	$2,034	$1,282	-
1989	8,428	-	-	364	$4,167
1991	14,586	3,306	-	-	2,917

Petitioners' corporation, Cost Less Auto Parts, Inc. (Cost Less), paid $175,000 to a shareholder (Leonard Jasiak) to buy his Cost Less stock. Around that time, Jasiak promised (for no consideration) that he would not compete against Cost Less.

The issues for decision are:[1]

1. Whether the fact that Jasiak voluntarily promised not to compete against Cost Less entitles Cost Less to amortize any of its payment for Jasiak's stock. We hold that it does not.

2. Whether Cost Less has shown that a $10,000 reduction in its ending inventory for each year in issue is necessary to clearly reflect its income. We hold that it has not.

3. Whether Cost Less or petitioners may deduct expenses for the business use of petitioners' vehicle or miscellaneous expenses that petitioner paid on behalf of Cost Lee. We hold that they may not.

4. Whether petitioners are liable for the addition to tax or penalty for negligence for 1988, and 1981. We hold that they are not.

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1 Petitioners concede that, if there are deficiencies in income tax for 1988 and 1991, they are liable for the addition to tax under sec. 6651 (a) (1) for those years.

Filed and entered November 7, 2001. Respondent determined that petitioners are liable for the addition to tax for failure to pay estimate tax under sec. 6654 for 1988 and 1989. We lack jurisdiction to decide this issue if petitioners filed income tax returns for years in which the addition is asserted. See sec. 6665 (b) (2); Meyer v. Commissioner, 97 T.C. 555, 562 (1991); Fujita v. Commissioner, T.C. Memo. 1999-164; Cherry v. Commissioner, T.C. Memo. 1997-346. Petitioners filed income tax returns for those years. Thus, we lack jurisdiction to decide whether petitioners are liable for the addition to tax under sec. 6654 for 1988 and 1989. Sec. 6665 (b) (2).

Section references are to the Internal Revenue Code as amended. Unless otherwise specified, Rule references are to the Tax Court rules of Practice and Procedure. References to petitioner are to John H. Miner.

I. FINDINGS OF FACT

Some of the facts have been stipulated and are so found.

E. Petitioners

Petitioners are married and lived in Tucson, Arizona, when they filed their petition in this case.

F. Cost Less Auto Parts, Inc.

1. Formation

Leonard Jasiak (Jasiak) and petitioner organized Cost Less Auto Parts, Inc. (Cost Less), in 1974. Petitioners owned 50 percent of the stock, and Jasiak and his wife owned the other 50 percent[2] from 1974 to the time Jasiak sold his shares to Cost Less. Cost Less was an S corporation under section 1361 during the years in issue.

2. Operation

Cost Less buys and sells new and used auto parts in Tucson. It has one place of business.

Jasiak and petitioner ran Cost Less. Jasiak was the general manager. He ordered and sold parts and supervised employees. He knew the business very well.

The auto parts business in Tucson was highly competitive during the years in issue. Cost Less had about 30 competitors within a 5-mile radius during the years in issue, including auto parts stores, new car dealerships, salvage yards, discount stores, drug stores, and grocery stores.

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2 At a date not stated in the record, Jasiak acquired his wife's interest so that he owned a 50-percent interest in Cost Less.

Jasiak started another auto parts store in 1975 or 1976, operated it about 1-1/2 years, and then closed it.

3. Sale of Jasiak's Cost Less Stock

In 1986, Jasiak decided that he wanted to retire and sell his stock to Cost Less. Jasiak intended to leave Tucson and not to compete with Cost Less. Jasiak orally promised petitioner that he would not compete with Cost Less. Jasiak and petitioner never discussed whether Cost Less would make any payment to Jasiak in exchange for Jasiak's promise not to compete.

Petitioner offered to have Cost Less pay Jasiak book value for his stock.[3] Jasiak wanted more than book value. They finally agreed that Cost Less would pay $175,000 for Jasiak's stock. Jasiak and petitioner did not discuss whether the payment to Jasiak was for a covenant not to compete.

Jasiak and petitioner went to Raymond Douglas Zirkle (Zirkle), Cost Less' lawyer. Zirkle prepared a draft agreement that included a covenant not to compete. Jasiak objected to the fact that Zirkle included a covenant not to compete in the draft agreement because he had already 0promised petitioner that he would not compete. Jasiak thought petitioner should have been satisfied with his promise that he would not compete. Jasiak refused to sign the agreement if it included a covenant not to compete.

Petitioner and Jasiak told Zirkle to delete the covenant not to compete from the written agreement. On December 24, 1986, Cost Less and Jasiak signed a written agreement which stated that Cost Less agreed to buy all of Jasiak's Cost Less stock for $35 per share for his 5,000

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3 The record does not show how much petitioner initially offered Jasiak for his stock.

shares, for a total of $175,000. Cost Less agreed to pay Jasiak $50,000 at closing, and the $125,000 balance at the rate of $3,100 per month beginning January 1, 1987, until paid. The written agreement states that it supersedes any "pre-existing agreements and understandings between the parties relating to the subject matter hereof, and may not be modified except in writing executed by both parties".

Jasiak and Cost Less amended the agreement in writing on February 13, 1987, to prohibit Cost Less from prepaying any of the balance due on the amount Cost Less owed Jasiak for his stock and to provide a security interest for the amount Cost Less owed Jasiak.

Jasiak did not compete with Cost Less after 1986.

4. Inventory

Cost Less had about 75,000 items in inventory during the years in issue. It kept records of its inventory on a computer with an inventory control software program. During the years in issue, as Cost Less received new inventory, its employees entered the cost of each new item into its computer program. When Cost Less employees entered the cost of new inventory items, the computer program automatically changed the amount stated as the cost of identical items remaining in inventory. For example, if Cost Less had a water pump in inventory which had cost $20, and Cost Less obtained another identical water pump for $30, the inventory program would show the cost of both water pumps as $30. The Cost Less computer program would then reduce inventory by $30 when the first water pump was sold.

5. Transportation

Cost Less had two pickup trucks to pick up and deliver parts. Petitioner also sometimes used his 1979 van for Cost Less errands. Less than a year before trial and at

least 6 years after the last year in issue, petitioner prepared a document from his own memory in which he estimated the number of miles that he drove his van for business in 1988, 1989, and 1991.

C. Income Tax Returns for Cost Less and Petitioners

Lawrence I. Subrin (Subrin) was Cost Less' accountant during the years in issue. Subrin prepared returns for Cost Less (Forms 1120) for 1988, 1989, and 1991. Cost Less filed its Federal income tax returns for 1988 on September 1, 1989, for 1989 on September 19, 1990, and for 1991 on September 17, 1992. About November 7, 1990, Cost Less filed an amended return for 1989 that Subrin had prepared.

In September or October 1993, petitioner asked Don Bailed (Bailey) a certified public accountant since 1983, to review petitioners' business and personal taxes. Bailey was petitioners' accountant from then through the date of trial. Bailey has three bachelor of arts degrees, a master of business administration degree, and he has completed about half of the hours required for a master's degree in taxation.

Bailey prepared joint Federal income tax returns for petitioners for the years in issue (1988, 1989, and 1991). Petitioners filed them on November 5, 1993.

Bailey asked petitioner about the $175,000 payment to Jasiak. Bailey asked Zirkle whether there was a covenant not to compete. Petitioner and Zirkle explained the circumstances surrounding Jasiak's sale of stock to Bailey. Bailey concluded that Cost Less was entitled to amortize the full $175,000 over a 7-year period, on the assumption that Cost Less paid $175,000 for a covenant not to compete and nothing for the stock. Bailey prepared amended returns for Cost Less in which Cost Less amortized the $175,000 over 7 years.

Petitioner told Bailey how the Cost Less inventory system worked. Petitioner estimated that Cost Less overstated its inventory by about $10,000 per year. Bailey accepted petitioner's estimate and reduced closing inventory by $10,000 on each of Cost Less' amended returns that he prepared.

Petitioner and Bailey also discussed petitioner's van use and payment of miscellaneous expenses. Petitioner did not give Bailey any incorrect information. In the amended returns Bailey prepared, Cost Less deducted $3,000 per year for petitioner's van use, and $50 per week for petitioner's payment of miscellaneous Cost Less expenses.

On December 15, 1993, Cost Less filed the amended income tax returns that Bailey prepared for 1988, 1989, and 1991. Respondent disallowed the changes Bailey made in Cost Less' amended returns.

Respondent mailed a notice of deficiency to petitioners on July 9, 1996. All of the adjustments in the notice of deficiency relate to Cost Less. Petitioners filed a petition in which they dispute the adjustments in the notice of deficiency and claim that they overpaid income taxes by $888 for 1988, $11,247 for 1989, and $1,363 for 1991.

II. OPINION

A. Covenant Not To Compete

1. Petitioners' Contentions

Cost Less amortized over 7 years all of the $175,000 payment it made to Jasiak to buy Jasiak's stock. Petitioners now contend that Cost Less may amortize only $165,000 of the $175,000 (i.e., the difference between $175,000 and what petitioners contend is the $10,000 book value of Jasiak's Cost Less stock).

In the alternative, petitioners contend that Cost Less may amortize amounts based on the value of the covenant not to compete. Petitioners point out that Jasiak orally promised that he would not compete against Cost Less around the time Cost Less agreed to buy Jasiak's stock. Petitioners contend that the amounts paid by Cost Less to Jasiak were consideration for Masiak's oral promise not to compete.

2. Analysis

A taxpayer may amortize a covenant not to compete from a departing shareholder if the parties intended that some of the payment from the business to the departing shareholder was for the covenant, and the amount agreed to be paid for the covenant reflected economic reality. See Patterson v. Commissioner, 810 P.2d 562, 571 (6th Cir. 1987), affg. T.C. Memo. 1985-53; Better Beverages, Inc. v. United States, 619 F.2d 424, 428 n.5 (5th Cir. 1980); Throndson v. Commissioner, 457 F.2d 1022, 1024-1025 (9th Cir. 1972), affg. Schmitz v. Commissioner, 314 F.2d 1, (8th Cir. 1962), affg. T. C. Memo. 1961-170. Thus, petitioner must prove that Jasiak and petitioner intended for some of the payment to be for a covenant not to compete and that the amount intended to be paid reflected economic reality. As discussed next, we conclude that petitioner proved neither point.

a. Whether Jasiak and Cost Less Intended to Allocate Part of the $175,000 to Jasiak's Promise Not To Compete

Petitioners contend that Jasiak and Cost Less intended to allocate part of the $175,000 to his promise not to compete. We disagree. There is no credible evidence that the parties intended to allocate any of the $175,000 to

Jasiak's promise not to compete. Before petitioner and Jasiak signed the agreement, Jasiak orally promised not to compete with Cost Less. They did not discuss allocating, much less did they allocate, any part of the $175,000 payment to Jasiak's promise not to compete.

In their written agreement, Jasiak and petitioner stated that Cost Less was paying $35 per share for 5,000 shares, for a total payment of $175,000. By its own terms, the agreement superseded all others and could be modified only in writing Petitioner and Jasiak agreed to a written change in the agreement barring prepayment and providing a security interest; this shows that they understood that changes in the agreement must be in writing.

Petitioners ask us to consider parol evidence of Jasiak's and petitioner's intent regarding payment for Jasiak's promise not to compete. Petitioners' reliance on parol evidence is unhelpful to petitioners for two reasons. First, the evidence is not credible. Petitioner testified that he intended for Jasiak's oral promise to be part of the written agreement and that he would not have agreed to Cost Less buying Jasiak's stock without Jasiak's covenant not to compete. Petitioners contend that Jasiak's testimony shows that petitioner intended that part of the $175,000 payment from Cost Less to Jasiak was for his oral promise not to compete. Jasiak testified that none of the $175,000 was for the covenant not to compete. Jasiak's testimony is consistent (and petitioner's position is inconsistent) with the written agreement and with Jasiak's and petitioner's decision to delete any references to a covenant not to compete from their written agreement. We found Jasiak's testimony to be more credible that petitioner's.

The second reason petitioners' reliance on parol

evidence is unhelpful to them is that under Arizona's parol evidence rule, we do not consider parol evidence where the written agreement is clear. Under Arizona's parol evidence rule, courts first consider parol or extrinsic evidence a party offers, and, if the written agreement is ambiguous and reasonably susceptible to the interpretation asserted by that party, the parol or extrinsic evidence is admissible to establish the intent of the parties. See Taylor v. State Farm Mut. Auto Ins. Co., 854 P.2d 1134, 1140 (Ariz. 1993). The written agreement is inconsistent with petitioners' position that the $175,000 was paid, in part, for Jasiak's promise not to compete. It is not ambiguous or susceptible to petitioners' interpretation. Thus, we do not consider petitioner's testimony to establish the intent of the parties. See Taylor v. State Farm Mut. Auto. Ins. Co, supra.

We conclude that Cost Less may not amortize any amount for Jasiak's oral promise not to compete because the parties did not allocate or intend to allocate any amount to it. Patterson v. Commissioner, supra Better Beverages, Inc. v. United States, supra; Annabelle Candy Co. v Commissioner, supra; Peterson Mach. Tool, Inc. v. Commissioner, 79 T.C. 72, 81 (1982), affd. 54 AFTR 2d 84-5407, 84-2 USTC par. 9885 (10th Cir. 1984); Major v. Commissioner, 76 T.C. 239, 247 (1981); Lucas v. Commissioner, 58 T.C. 1022, 1032 (1972).

b. Whether There Is Evidence of the Value of Jasiak's Promise Not To Compete

Petitioners contend that Jasiak's oral promise not to compete was valuable. Petitioners contend that the fact that Jasiak knew the auto parts business well and that he started another auto parts store in 1975, which was open for about 1-1/2 years, shows that the covenant not to compete had value. Petitioners contend that the value of

the covenant not to compete is $175,000 less the book value of Cost Less which petitioners contend is $10,000.

We disagree. We believe Jasiak's oral promise to Cost Less not to compete had little or no value. The fact that Jasiak opened another auto parts store in 1975, which was open 1-1/2 years, does little to show he was a competitive threat to Cost Less when he wanted to retire in 1986. The auto parts business was highly competitive. It is not clear whether his oral promise included a specific duration or geographic area. His oral promise provided for no consideration. Thus, it may not have been enforceable. See Amex Distrib. Co. v. Mascari, 724 P.2d 596, 601 (Ariz. Ct. App. 1986); American Credit Bureau, Inc. v. Carter, 462 P.2d 838, 840 (Ariz. Ct. App. 1969).

If we knew the fair market value of Jasiak's Cost Less stock, and we knew that the $175,000 payment was intended to be made for both the stock and a covenant not to compete, then, as petitioners request, we might be able to derive the value of the covenant. See, e.g., Annabelle Candy Co. v. Commissioner, supra at 7-8; Beaver Bolt, Inc. v. Commissioner, T. C. Memo. 1995-549; Standard Lumber & Hardware Co. v. Commissioner, T.C. Memo. 1958-159. But we cannot do that here because Jasiak and petitioner intended there to be no payment for Jasiak's promise not to compete.

Petitioner did not offer any evidence to show the fair market value of the stock. Instead, petitioner contends that $10,000 is the book value of Jasiak's Cost Less stock. We disagree that it is appropriate to use $10,000 as the fair market value of Jasiak's Cost Less stock. First, Jasiak rejected petitioner's offer to sell the stock for book value, which suggests its fair market value was higher. Second, petitioners offered no convincing evidence that the book value of Cost Less stock was $10,000. Bailey testified that

the book value and par value of Cost Less were both "about" $1 per share, for a total of $10,000. Petitioners offered no records or other corroboration for this point. Bailey's explanation how he computed book value was unconvincing. He testified that par value[4] was $1 per share, and that this was also its book value.[5] We are not convinced from Bailey's testimony that the book value of a share of Cost Less stock is equal to its par value, or that the fair market value of Jasiak's Cost Less stock is $10,000 here.

We conclude that there is no credible evidence that Jasiak's oral promise not to compete had any value.

c. Whether To Estimate an Amount to Allocate to Jasiak's Promise Not To Compete

Petitioners contend that we should apply the Cohan rule (enunciated in Cohan v. Commissioner, 39 F.2d 540, 543-544 (2d Cir. 1930)), to estimate an amount for Jasiak's promise not to compete if we decide that Cost Less may not amortize $165,000. We disagree. We may estimate an amount under Cohan if the taxpayer is entitled to deduct some amount. See id. Here, as discussed above at paragraph II-A-2-a, Cost Less may not deduct any amount for Jasiak's promise not to compete because Jasiak and petitioner intended to allocate none of the

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4 Par value is an arbitrary value assigned to a share of stock by the corporation's charter. See Kohler, Kohler's Dictionary for Accountants 374 (5th ed. 1983); Nickerson, Accounting Handbook for Nonaccountants 176 (1975).

5 The book value of a share of common stock is equal to assets of the corporation less liabilities divided by the number of outstanding shares. See Kohler, supra at 71.

$175,000 payment to Jasiak's promise. Thus, Cohan does not apply.

d. Cases Cited by Petitioners

Petitioners contend that this case is indistinguishable from Standard Lumber & Hardware Co. v. Commissioner, supra, in which we permitted the taxpayer to amortize the cost of a covenant not to compete. Petitioners contend that Standard Lumber & Hardware Co. supports the proposition that Cost Less may allocate part of the $175,000 payment to Jasiak to a covenant not to compete despite the terms of the written agreement of sale. Petitioners also contend that Standard Lumber & Hardware Co. supports the proposition that the value of (and amount paid for) the stock in Cost Less is its book value, leaving the rest of the $175,000 payment from Cost Less to Jasiak to be allocated to the covenant not to compete. We disagree.

In Standard Lumber & Hardware Co., the partners had a written partnership agreement which stated that the remaining partners would pay a withdrawing partner an amount equal to the book value ($32,587.22) of his partnership interest. The partners had an oral agreement that any departing partner would not compete against the partnership. The partners signed a dissolution agreement. The remaining partners paid the withdrawing partner $70,000 by check. The dissolution agreement and check said that the $70,000 was for the withdrawing partner's interest in the partnership. Neither the dissolution agreement nor the certified check mentioned a covenant not to compete. The remaining partners continued to operate the business and did not amortize the covenant. A successor corporation filed an amended return and amortized part of the $70,000 as the cost of the covenant. We found that $37,412.78 (the difference between

$32,587.22 and $70,000) was intended to be paid fro the covenant not to compete.

Here, in contrast, Jasiak specifically rejected any payment for his promise not to compete, and he specifically rejected being paid for his stock based on the book value of his stock. Thus, Standard Lumber & Hardware Co. is significantly different from this case.

Petitioners cite Patterson v. Commissioner, 810 F.2d at 571, for the proposition that a covenant not to compete has value if it has economic reality. Petitioners' reliance on Patterson is misplaced; Patterson is in accord with respondent's position here. We held in Patterson that the taxpayer could not amortize any amount because there was a written agreement in which all of the payment to the withdrawing party was specifically for stock and goodwill and none was for a covenant not to compete. See id. at 573. This was so even though there was a covenant not to compete which may have had some value. Like the taxpayer in Patterson, petitioner and Jasiak signed an agreement which said all of Cost Less' payment to Jasiak was for stock. Thus, whether the covenant not to compete had independent value does not alter the outcome of this case.

In none of the other cases petitioners cite was there a written agreement specifying that all of the payment to the withdrawing party was for stock. See Schulz v. Commissioner, 294 F.2d 52, 55 (9th cir. 1961), affg. 34 T.C. 235 (1960); O'Dell & Co. v. Commissioner, 61 T.C. 461, 467 (1974); United Fin. & Thrift Corp. v. Commissioner, 31 T.C. 278, 285-286 (1958), affd. 282 F.2d 919 (4th Cir. 1960); Silberman v. Commissioner, 22 T. C. 1240 (1954); Michaels v. Commissioner, 12 T.C. 17, 19 (1949); B. T. Babbitt, Inc. v. Commissioner, 32 B.T.A. 693, 696 (1935); Fletcher v. Commissioner, T. C. Memo. 1965-

273.

3. Conclusion

We conclude that petitioner may not amortize any of Cost Less' $175,000 payment for Jasiak's oral promise not to compete because petitioner and Jasiak did not intend to allocate any of the payment to the promise, and petitioner has not proven that Jasiak's promise had value.

B. Inventory adjustment

Petitioners contend that Cost Less may reduce its ending inventory by $10,000 for each year in issue because, according to petitioners' estimate, Cost Less' inventory software overstated its ending inventory by that amount.

We have long held that a taxpayer may adjust inventories to correctly reflect income. Elm City Nursery Co. v. Commissioner, 6 B.T.A. 89 (1927); Baumann Rubber Co. v. Commissioner, 4 B.T.A. 671 (1926). Petitioners do not explain how they computed the $10,000 amount. Petitioners appear to defend the $10,000 amount because the consumer price index (CPI) increased .185 percent on all items from January 1, 1988, to December 31, 1991. However, they did not show (1) how many of the 75,000 parts had price increases in any year; (2) how many parts remained in inventory at the end of the year for which the computer program increased costs; (3) the amount of price increases; (4) what happens if inventory prices decrease; or (5) whether Cost Less used first in first out, or last in first out, or any other method.

Petitioners contend that respondent conceded that they overstated the inventory of Cost Less. We disagree. Respondent agrees that petitioners' inventory records are not accurate but not that Cost Less overstated its inventory.

Petitioners contend that we must allow Cost Less to

adjust its inventory, citing Western Wheeled Scraper Co. v. Commissioner, 14 B.T.A. 496, 504 (1928). Petitioners' reliance on Western Wheeled Scraper Co. v. Commissioner, supra, is misplaced. That case holds that a taxpayer may adjust its inventory to correct clear errors. In that case the Board of Tax Appeals allowed the taxpayer to adjust inventory for specific items and amounts which the taxpayer showed were duplicated in inventory but not for other, value items. See id. at 504-505.

Cost Less may not reduce its ending inventory without showing the amount of the adjustment that is needed to clearly reflect income. We conclude that Cost Less may not reduce inventory by $10,000 for any of the years in issue.

C. Deduction for Van Use

Petitioner used his 1979 van for business from the early 1980's through the years in issue. Petitioners contend that Cost Less may deduct an amount based on the mileage that petitioner estimated for business use of his van for 1988, 1989, and 1991. We disagree.

A taxpayer may not deduct costs for the use of a passenger vehicle unless the taxpayer substantiates the amount of the expense, the time and place of travel, and the business purpose of travel with adequate records or sufficient evidence corroborating the taxpayer's statement. See sec. 274 (d).

Petitioners contend that section 274 (d) does not apply to petitioner's van. We disagree. Section 274 (d) applies to passenger automobiles and other property used as a means of transportation. See sec. 280F(d) (4) (A) (i) and (ii). A passenger automobile is any 4-wheeled vehicle (including vans) which is manufactured primarily for use on public streets, roads, and highways and is rated at 6,000 pounds gross vehicle weight or less. See sec.

280F(d)(5)(A). Petitioners have not shown that the van has a gross weight of 6,000 pounds or more. Thus, the substantiation requirements of section 274(d)(4) apply to petitioner's van.

Less than a year before trial and at least 6 years after the last year in issue, petitioner prepared a written estimate of his business mileage from memory. He did not use any records to prepare the estimate. Petitioner's testimony and written estimate of his business mileage fail to satisfy the substantiation requirements of section 274(d). See sec. 1.274-5, Income Tax Regs. We conclude that petitioners have not met the requirements of section 274(d). See Nicholls, North, Buse Co. v. Commissioner, 56 T.C. 1225, 1235-1236 (1971); Kennelly v. Commissioner, 56 T.C. 936, 942 (1971), affd. 456 F.2d 1335 (2d Cir. 1972); Marlin v. Commissioner, 54 T.C. 560, 568 (1970); Thorpe v. Commissioner, T.C. Memo. 1998-115; Tesar v. Commissioner, T.C. Memo. 1997-207; Group Admin. Premium Servs., Inc. v. Commissioner, T.C. Memo. 1996-451. Thus, Cost Less may not deduct business use of the van in the years in issue.

D. Deduction for Miscellaneous Expenses

Ordinarily, a shareholder may not deduct a payment made on behalf of the corporation but must treat it as a loan or a capital contribution. See Deputy v. DuPont, 308 U.S. 488 (1940); Betson v. Commissioner, 802 F.2d 365, 368 (9th Cir. 1986), affg. In part, revg. In part T.C. Memo. 1984-264; Rink v. Commissioner, 51 T.C. 746, 751 (1969); see also sec. 1.263(a)-2(f), Income Tax Regs. Petitioners contend that petitioner occasionally paid for miscellaneous items such as photocopies and breakfast and lunch for Cost Less' employees and customers, and that Cost Less did not reimburse petitioner for those expenses. Petitioners contend that Cost Less may deduct $50 per

week for those expenses. However, petitioners have no records to substantiate their claim that petitioner paid these amounts.

Petitioners tried to show that payments of these expenses are capital contributions to Cost Less. Bailey testified that he credited the estimated amount of the payments to petitioner's equity account in the corporation. Bailey did not say when or how he credited petitioner's equity account. Bailey did not begin doing accounting work for Cost Less until 1993, which is after the years in issue. Petitioners offered no accounting records into evidence. We are not convinced that the expenses were capital contributions to Cost Less.

The result would be no different even if petitioners had shown that the expenses were capital contributions to Cost Less. Petitioners have not substantiated the expenses or shown that those expenses were ordinary and necessary expenses of Cost Less as required under section 162. To the extend that petitioner paid for meals, petitioners have failed to show that they complied with section 274(d).

We conclude that neither Cost Less nor petitioners may deduct these amounts.

E. Negligence

Petitioners contend that they are not liable for the addition to tax for negligence under section 6653(a)(1) for 1988 and section 6662 for 1989 and 1991 because they relied on Bailey.

Respondent contends that petitioners may not rely on Bailey because, in retaining Bailey and following his advice petitioners were ignoring apparently correct advice previously provided by Subrin. Respondent contends that petitioners looked for an accountant who would give the advice that resulted in the lowest tax liability.

Petitioners changed from Subrin to Bailey in 1993.

We think petitioners reasonably believed that Bailey was qualified to provide tax advice. We conclude that they are not liable for the addition to tax for negligence.

To reflect the foregoing,

Decision will be entered under Rule 155.

UNITED STATES TAX COURT

JOHN H. MINER and HOLLY K. MINER,	)	
Petitioners,	)	
v.	)	Docket No. 21663-96
COMMISSIONER OF INTERNAL REVENUE	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed October 26, 1999, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax due from the petitioners for the taxable years 1988, 1989 and 1991 in the amounts of $13,717.00, $8,428.00 and $14,586.00, respectively;

That there is an overpayment in income tax for the taxable year 1989 in the amount of $2,171.77, which

amount was paid on August 17, 1990, and for which a claim for refund could have been filed, under the provisions of I.R.C. § 6511 (b) (2), on July 9, 1996, the date of the mailing of the notice of deficiency;

That there are additions to tax due from the petitioners for the taxable years 1988 and 1991, under the provisions of I.R.C. § 6654, in the amounts of $1,282.00 and $364.00, respectively;

That there is no addition to tax due from the petitioners for the taxable year 1988,
under the provisions of I.R.C. § 6653 (a) (1); and

That there are no penalties due from the petitioners for the taxable years 1989 and 1991, under the provisions of I.R.C. § 6662(a).

(Signed) John O. Colvin
Judge.

Entered: MAR 7, 2000

UNITED STATES TAX COURT
WASHINGTON, DC 20217

JOHN H. MINER and HOLLY K. MINER,	)	
Petitioners	)	Docket No. 21663-96.
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

ORDER

On September 23, 1998, respondent's motion for partial summary judgment and supporting memorandum were filed. On October 15, 1998, petitioners' objection to respondent's motion for partial summary judgment was filed. On October 20, 1998, petitioners' supplemental objection to respondent's motion for partial summary judgment was filed. For cause, it is

ORDERED that respondent's motion for partial summary judgment is denied as moot.

"s/ John O. Colvin"
Judge

Dated: Washington, D.C.
October 26, 1999

AGREEMENT

THIS AGREEMENT entered into this 24 day of December, 1986, by and between LEONARD JASIAK, a single man, hereinafter referred to as "SHAREHOLDER", and COST LESS AUTO PARTS, INC., an Arizona corporation, hereinafter referred to as "CORPORATION."

WITNESSETH

WHEREAS, the CORPORATION currently has issued and outstanding Ten Thousand shares (10,000) of Common Stock; and

WHEREAS, SHAREHOLDER is the owner of Five thousand (5,000) shares of COST LESS AUTO PARTS, INC. comm0on Stock, and SHAREHOLDER desires ti withdraw

from the CORPORATION and to sell all of his shares to CORPORATION; and

WHEREAS, the CORPORATION through its Board of Directors desires to acquire and purchase the five thousand Shares (5,000) of Common Stock held by the SHAREHOLDER.

NOW, THEREFORE, IN CONSIDERATION OF THE PREMISES AND THE MUTUAL COVENANTS AND AGREEMENTS CONTAINED HEREIN, THE PARTIES HERE DO AGREE AS FOLLOWS:

1. Concurrently with the execution with this Agreement, upon the terms and subject to the conditions hereinset forth, SHAREHOLDER, against payment by CORPORATION as provided in Section 2 herewith transfers, conveys, assigns and delivers to CORPORATION the shares together with such certificates, stock powers, endorsements, assignments, signature guarantees and other good and sufficient instruments of transfer and conveyance as shall be necessary or appropriate to vest in or confirm to purchaser's all of the right, title and interest of SELLER in and to the shares free and clear of any liens, claims, pledges or other encumbrances, and with all necessary stamps for applicable stock transfer tax affixed.

ii. CONSIDERATION AND PAYMENT:

The total purchase price for the Shares shall be THIRTY-FIVE DOLLARS ($35.00) per share for a total of ONE HUNDRED AND SEVENTY FIVE THOUSAND DOLLARS, ($175,000.00) payable as follows:

i. FIFTY THOUSAND DOLLARS ($50,000.00) on the date of closing which shall be in the form of a combination of merchandise and cash to agreed upon by SHAREHOLDER and CORPORATION on date of closing.

ii. The balance of ONE HUNDRED AND

TWENTY FIVE THOUSAND DOLLARS ($125,000.00) shall be evidenced by a Promissory Note executed by the CORPORATION carrying interest at the rate of Twenty-four percent (24%) per annum. Said interest is to commence on January 1, 1987. Payments on the Note by the CORPORATION to the SHAREHOLDER shall be in the amount THREE THOUSAND ONE HUNDRED DOLLARS ($3,100.00) per month on the first day of each and every month commencing on January 1, 1987, until paid in full. Payments on said Promissory Note shall first be applied to the interest due and owing and then to the principal. The Promissory Note shall bear no prepayment penalty.

3. The consummation of the conveyance, transfer, assignment and delivery to CORPORATION of the Shares in exchange for the consideration set forth above shall constitute Closing. Closing shall take place at 6416 East Tanque Verde, Suite C, Tucson, Arizona, or another location to be mutually agreed upon by the parties on or before December 31, 1986.

4. During the period of time in which the Promissory Note is being paid, CORPORATION hereby agrees to maintain a life insurance policy on the life of JOHN H. MINER in an amount no less than the unpaid balance due and owing on the Promissory Note described herein.

3. SHAREHOLDER'S KNOWLEDGE:

SHAREHOLDER acknowledges that since the inception of the CORPORATION that he has been a fifty percent (50%) Shareholder in the CORPORATION, and has personal knowledge of the following matters concerning the CORPORATION:

(a) The CORPORATION's articles, by-laws and minutes.

(b) Any investments that the

CORPORATION may have made.

(c) Property, inventory and other assets owned by the CORPORATION.

(d) All contractual obligations of the CORPORATION and litigation, if any, involved with the CORPORATION.

(e) The amount of the authorized capital of the CORPORATION, and the number of issued and outstanding shares of stock along with the name of the owners of the stock.

(f) Knowledge of the most recent financial statements of the stock, along with knowledge of the bank accounts, checking accounts and other deposits in financial institutions in the name of the CORPORATION.

(g) All liabilities and indebtedness of the CORPORATION.

(h) All Trademarks.

(i) All management and employment contracts, if any, with the CORPORATION, along with any profit-sharing bonus stock option, pension, retirements, stock purchase, hospitalization or other plans entered into by the CORPORATION involving the Shareholders and/or Officers and Board of Directors of the CORPORATION.

[j] All interest owned by the CORPORATION in any real estate of whatsoeverkind.

(k) Information concerning the federal, state and other tax returns required to be filed by the CORPORATION pursuant to governmental bodies.

(l) Leases, agreements and other contracts of whatsoever kind.

(m) Knowledge of all accounts, receivables and payables of the CORPORATION.

6. Both SHAREHOLDER and CORPORATION hereby acknowledge and represent that no brokerage fees,

finder fees or agent's commissions, or other similar forms of compensation in connection with this Agreement or any transaction contemplated hereby is owed to any individual of entity.

7. SHAREHOLDER hereby warrants that SHAREHOLDER is the sole owner of the shares being sold hereunder free and clear of all liens and encumbrances, judgments and other clouds of any nature of whatsoever. SHAREHOLDER further agrees that between the time of execution of this Agreement and the delivery of the Shares to CORPORATION at closing, that SHAREHOLDER shall not allow any liens, security agreements, judgments or other encumbrances to be placed against the shares, and that at the time of closing the shares shall be free and clear of all encumbrances.

8. CORPORATION hereby warrants that is has been duly authorized pursuant to the provisions of its Articles and By-Laws to purchase the shares from SHAREHOLDER on the terms and conditions contained in this Agreement.

9. Any one or more of the following event shall constitute default by the CORPORATION hereunder:

(a) If CORPORATION defaults in the payment of either the principal or the interest of the Note.

(b) If CORPORATION defaults in discharging any obligation for the payment of borrowed money, or any obligation under any factoring or financing agreement, and if such default is not cured within the applicable grace period or if it is not cured within thirty (30) days written notice by SHAREHOLDER to CORPORATION that SHAREHOLDER intends to regard such default as a default pursuant to this Agreement.

(c) If CORPORATION becomes involved in financial difficulties as evidenced: (1) By an admission in

writing of its inability to pay its debts generally as they become due or (2) by filing of a voluntary petition in bankruptcy or for reorganization or adoption of any arrangement under the Bankruptcy Act or an admission seeking relief therein or (3) by making of an assignment for benefit of creditors or (4) by consenting to the appointment of receiver for all or substantial of its property or (5) by being adjudicated a bankrupt or (6) by the entry of an Order by the Court appointing a receiver or Trustee for all or a substantial part of its property or proving an involuntary petition filed for or affecting an arrangement in bankruptcy or for a reorganization pursuant to the aforementioned Bankruptcy Act or for any other judicial modification or alteration of the rights of creditors or (7) by the assumption of custody, attachment, or sequestration by a Court of competent jurisdiction a significant part of its property which custody, attachment, or sequestration shall not be suspended or terminated within thirty (30) days from its inception.

10. In the event of any default of any of the terms of this Agreement by CORPORATION, SHAREHOLDER shall give CORPORATION a written notice of said default. CORPORATION shall have thirty (30) days from the receipt of the written notice to cure the default. In the event the default is not cured within the prescribed time, SHAREHOLDER may declare all indebtedness, principal and interest owing by CORPORATION to him under the notes to be forthwith due and payable without presentment, demand, protest or other notices of any kid of which are expressly waived.

11. The representations, warranties, covenants and agreements contained in this Agreement shall survive the closing date.

12. SUCCESSORS AND ASSIGNS:

The rights and obligations of SHAREHOLDER in this Agreement shall not be assignable without the prior written consent of CORPORATION. Subject to the foregoing limitation on assignment, the provisions of this Agreement shall be binding upon and inur to the benefit of the parties hereto and their respective successors and assigns. Nothing herein expressed or implied is intended to confer upon any person, other than the parties hereto or named herein and their respective successors or assigns, any right, remedy obligation or liability under or by reason of the this Agreement.

13. ENTIRE AGREEMENT:

This Agreement constitutes and contains the entire and only Agreement between the parties concerning the subject matter hereof and supersedes and cancels any and all pre-existing agreements and understandings between the parties relating to the subject matter hereof, and may not be modified except in writing executed by both parties:

TO SHAREHOLDER: LEONARD JASIAK
2705 E. Spring St.
Tucson, AZ 85716

TO CORPORATION: COST LESS AUTO PARTS, INC.
3652 Sixth Avenue
Tucson, AZ 85713

or to such other addresses as may from time to time be designated in writing by Notice to the parties.

14. GOVERNING LAW:

This Agreement shall be governed by and construed in accordance with the laws of the State of

Arizona.

15. ATTORNEYS' FEES:

If either party is required to obtain the services

of an attorney to enforce the terms of this Agreement, then the prevailing party shall be entitled to reasonable attorneys' fees incurred herein, expenses and other costs from the other party.

IN WITNESS WHEREOF, the parties hereto have executed the document the day and year above written.

CORPORATION:

COST LESS AUTO PARTS, INC.
an Arizona corporation

BY "s/ John W. Miner"

SHAREHOLDER:

"s/ Leonard Jasiak"
LEONARD JASIAK

STATE OF ARIZONA)
) ss:
COUNTY OF PIMA)

On this, the 24 day of December, 1986, before me the undersigned Notary Public, personally appeared JOHN MINER, who acknowledged himself to be the PRESIDENT of COST LESS AUTO PARTS, INC., an Arizona corporation; and that he, as such officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

"s/ Geraldine Stilwell"

My Commission Expires:
4-17-87

STATE OF ARIZONA)
) ss:
COUNTY OF PIMA)

On this, the 24 day of December, 1986, before me the undersigned Notary Public, personally appeared LEONARD JASIAK, SHAREHOLDER and executed the foregoing instrument as and for the purposes therein contained.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

"s/ Geraldine Stilwell"

My Commission Expires:
4-17-87

ADDENDUM TO AGREEMENT

COME NOW, LEONARD JASIAK, a single man, hereinafter referred to as "SHAREHOLDER, and COST LESS AUTO PARTS, INC., an Arizona corporation hereinafter referred to as "CORPORATION", and hereby agree that the Agreement entered into by and between SHAREHOLDER and CORPORATION on the 24th day of

December 1986, wherein CORPORATION purchased from SHAREHOLDER all of SHAREHOLDER'S stock in CORPORATION be amended as follows:

1. That on page 2 paragraph 2. (b), the last sentence be deleted and the following sentences substituted: this Promissory Note shall not be prepaid in any manner. To secure payment of the amount evidence by the Promissory Note, SHAREHOLDER shall have a security interest in the shares of stock being purchased by the CORPORATION from the SHAREHOLDER, and said shares shall have evidenced upon them notation of said security interest held by SHAREHOLDER.

DATED this 13 DAY OF Feb., 1987.

SHAREHOLDER:

CORPORATION:
COST LESS AUTO PARTS, INC.
An Arizona corporation

"s/ Leonard Jasiak"
LEONARD JASIAK

BY "s/ John Miner"
JOHN MINER, President

STATE OF ARIZONA)
) ss:
COUNTY OF Mohave)

On this the 13 day of February, 1987, before me the undersigned Notary Public, personally appeared JOHN MINER, who acknowledged himself to be the President of COST LESS AUTO PARTS, INC., an Arizona corporation; and that he, as such officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

/s/ "Illegible"
Notary Public

My Commission Expires:
April 24, 1986

STATE OF ARIZONA)
) ss:
COUNTY OF PIMA)

On this, the 13 day of February, 1987, before me the undersigned Notary Public, personally appeared LEONARD JASIAK, SHAREHOLDER and executed the foregoing instrument as and for the purposes therein contained.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

"s/ Geraldine Stillwell"

My Commission Expires:
4-17-87

UNITED STATES TAX COURT

In the Matter of:	)
	)
JOHN E. & HOLLY K.	)
MINER,	) DOCKET NO.
Petitioners,	) 21663-96
v.	)
	)
COMMISSIONER OF	)
INTERNAL REVENUE,	)
	)
Respondent.	)

Tuesday,
October 20, 1998

Federal Bldg. & U.S. Post
Office, Room 235
522 North Central Avenue
Phoenix, AZ 85004

The above-entitled matter came on for trial, pursuant to notice, at 2:00 P.M.

BEFORE: HONORABLE JOHN O. COLVIN
Judge

APPEARANCES:

On behalf of Petitioner:
HUGH KELLY, ESQ.
3035 E. Weldon
Phoenix, Arizona
(602) 957-7080

On behalf of Respondent:
JOHN W. DUNCAN, ESQ.
Office of District Counsel
Internal Revenue Service
210 E. Earll Drive, M/S 2200 PX
Phoenix, AZ 85012
(602) 207-8052

Video/Audio Recording Services, Inc.
2430 K Street, Suite 100
Sacramento CA 95816
(916) 448-2457

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we'll cross those bridges as they come.

MR. DUNCAN: And, Your Honor, you know, I will make the point that just because parties have different views, does not make them a hostile witness, necessarily. Usually, there's something in the relationship that would cause a party to be hostile.

THE COURT: Well, a different recollection of

conversations in which they both participated would be enough.

MR. DUNCAN: Thank you. Your Honor.

THE COURT: Mr. Kelly, go right ahead. You need to – well, that's fine. We'll be off the record a minute while you bring him in.

(Off record)

THE COURT: Mr. Kelly, Yes, you just called Mr. Jasiak.

THE CLERK: Sir, can you please stand and raise your right hand?

Whereupon

LEONARD JASIAK,

having been first duly sworn was called as a witness herein, and was examined and testified as follows:

THE CLERK: Please be seated. Please state your name and address for the record, and please spell your name.

THE WITNESS: My name is Leonard Jasiak, J-a-s-i-a-k, and I live at 6817 East Calle Marte.

THE CLERK: Thank you.

THE WITNESS: Tucson, Arizona, 85710.

THE CLERK: Thank you.

THE COURT: Thanks for coming in to testify, Mr. Jasiak.

THE WITNESS: You're welcome.

THE COURT: Mr. Kelly.

DIRECT EXAMINATION

BY MR. KELLY:

Q Mr. Jasiak, you and Mr. Miner were co-shareholders of a corporation called Cost Less Auto Parts, Inc., were you not?

A Yes.

Q And Cost Less Auto Parts was incorporated in

1974?

A Right.

Q And you became co-shareholders, at that time?

A Right.

Q During the course that you were a shareholder, I assume you were also one of the directors of Cost Less, is that correct?

A Yes.

Q And as part of it, as a director, you and Mr. Miner, the other director, conducted the corporate business, is that correct?

A That's right.

Q And during the time that you were a director of Cost Less, you started another auto parts store on your own, isn't that correct?

A Yes.

Q And –

MR. DUNCAN: Objection, Your Honor. I don't see the relevance of this line of questioning. We're trying to determine whether there was a covenant not to compete here.

THE COURT: Overruled.

BY MR. KELLY:

Q When did you start that other auto parts store?

A I really don't recall, exactly. It was around 1975 or '76, somewhere in there.

Q And how long did you operate that, sir?

A About a year and a half.

Q And then you closed it down?

A Yes.

Q Now, when you – when you – when you – when you started the other store, did you ask John Miner

if it was okay with him if you had another store?

A No.

Q Didn't ask him?

A No.

Q You just started it on your own?

A Yes.

Q Okay. Now, when there came a time in December, or prior to December of 1986, you decided you wanted to retire out of the Cost Less business, isn't that correct?

A That's right.

Q What was – tell the Court what your – what your primary duties were in Cost Less?

A Well, just more or less general manager, ordering parts and helping sell parts, and helping to regulate the employees.

Q It's fair to say, isn't it, that you knew the business pretty much backwards and forwards?

A Yes, I did.

Q And, it's also fair to say that Mr. Miner depended a great deal on your ability, isn't that correct?

A Well, I'd say we depended on each other.

Q Okay. Now, in 1986, at some point in time, you decided you wanted to retire, is that correct?

A That's right.

Q And when you decided that, you went to your attorney, Mr. Zirkle –

MR. DUNCAN: Your Honor, I want to object here as to the clarification of exactly whose attorney Mr. Zirkle is, whether they're talking attorney for the company, attorney for the individual. I'd like that question to be clarified.

THE COURT: That's appropriate. Mr. Kelly?

MR. KELLY: Most of this testimony will be,

Your Honor, be connected. I will connect it.
BY MR. KELLY:

Q You went to Mr. Zirkle, isn't that correct?

A Well, I wouldn't say I went to Mr. Zirkle. We went to Mr. Zirkle.

Q Mr. Zirkle was the –

A Because he was our company lawyer.

Q Mr. Zirkle was your company lawyer.

A Right.

Q Isn't that true?

A That's right.

Q And, was he your personal lawyer, too?

A Not at that time.

Q Okay. He was –

A Later on, he was, but not at that time.

Q And do you know if he's still the company lawyer today?

A No, I don't.

Q Okay. And, when you got together with Mr. Zirkle, was Mr. Miner with you?

A I don't recall, I would just imagine we'd be together.

Q And, did you tell – what did you tell Mr. Zirkle that you were there for?

A Well, I wanted to sell my share of the business to Mr. Miner.

Q And, do you recall what – do you know whether or not Miner was there?

A Well, I don't recall whether he was there or not, but we always did important business things together.

Q Did you tell Mr. Zirkle – did you ask Mr. Zirkle – well, you asked Mr. Zirkle, did you not, to draw up an agreement for the purpose of disposing of your stock back to the corporation?

A Well, I think – I think John took care of that. He talked to Mr. Zirkle about making an agreement and our accountant was supposed to be involved in that, too.

Q Okay. And, so, then you're talking about John Miner?

A Right.

Q And, so, did there come a time when Mr. Zirkle presented you and Mr. Miner with a draft of an agreement?

A Yes.

Q And in that agreement, and in that draft of agreement, there was a covenant not to compete, was there not?

MR. DUNCAN: Objection, Your Honor; hearsay. Any such document can speak for itself. If there's a document out there like that, let's see it.

THE COURT: Whether a document can speak for itself doesn't indicate whether this is hearsay. The question could be answered from this witness' personal knowledge. So, I'm not sure – he's just describing something that he saw, isn't that right?

MR. DUNCAN: Well, describing a scene or something, but, you know, describing words, I believe is, you know, the definition of hearsay, that this document said is the same as saying, you know, Bill Jones said, so far as hearsay goes. But, you know, if the document could be produced, then we would have the document.

MR. KELLY: I didn't ask him what the document said. I asked him if there was a covenant not to compete in it.

THE COURT: Overruled.

BY MR. KELLY:

Q In that draft and agreement, there was a covenant not to –

THE COURT: Mr. Kelly.

MR. KELLY: Yes.

THE COURT: I do want to say one thing. There was some discussion of the record about the status of this witness in terms of your examination, compared to Mr. Duncan's examination. There's been no ruling, yet, on that status, so the normal rules of examination apply until you demonstrate an occasion to change those rules.

MR. KELLY: All right.

THE COURT: Which I have not see yet.

BY MR. KELLY:

Q State whether or not – state whether or not there was a covenant not to compete in that document?

A As far as I know, there wasn't.

Q In the first draft?

A No.

Q There was no such covenant?

A No

Q Is it true, or will you state to the Court whether or not it's true that the subject of a covenant not to compete came up at that time?

A No.

Q At no time you ever discussed a covenant not to compete?

A Not with the lawyer.

Q Did you ever discuss a covenant not to compete with Mr. Miner?

A The only way we discussed it is that either he or I said we don't need one because I'm leaving town. I was leaving town so we felt we didn't need it.

Q Well, didn't you stay in Tucson after the closing of this transaction and work for Cost Less?

A I just stayed and worked for two months for John because he –

Q How long did you stay in Tucson?

A February of '87 I was gone to Lake Havasu City.

Q And how long did you stay there?

A Five years.

Q Now, did you – and, at the time, you're saying Mr. Miner told you that we didn't need a covenant, is that true?

A I don't remember whether he said it or I said it, but somebody said that we don't really need it because I'm moving anyhow, so it doesn't make any difference.

Q Now, did there ever come a time when you felt like Mr. Miner had not paid you everything that you were entitled to?

MR. DUNCAN: Objection, Your Honor. I don't see the relevance of this question.

THE COURT: Mr. Kelly?

MR. KELLY: Well, it's relevant if you want me to show the condition that you just spoke about.

THE COURT: Oh, I see.

MR. DUNCAN: Your Honor, he's answered all the questions been asked of him to this point. You know, if at some point, you know, that Mr. Jasiak does appear to be a reluctant witness, you know, we can go into those things at that point. But until such time, Mr. Jasiak is answering all the questions, apparently, forthrightly here. I don't see the relevance of this.

THE COURT: Overruled. You may proceed, Mr. Kelly.

BY MR. KELLY:

Q Did there ever come a time when you felt like Mr. Miner was not getting everything that was coming to you as a result of the transaction where you disposed of all of your stock to the corporation?

A I don't understand your question. That he wasn't getting?

Q No, you.

A Oh, because you said that he wasn't getting everything.

Q Ever come a time when you felt like he wasn't getting everything to you that you were entitled to?

A Well, that depends. As far as the sale of the business was concerned, I got everything that I was entitled to, in that.

Q How about the pension plan?

A Yes, I got that.

Q And did you get everything you thought you were entitled to?

A As far as the business was concerned, yes. But there were other incidents that happened that I didn't get.

Q And what is that?

MR. DUNCAN: Again, Your Honor, I'm questioning the relevance here, where we're going with this.

THE COURT: It's relevant to the relationship between these two people. Overruled.

BY MR. KELLY:

Q And what are the other instances, sir?

A Well, John had verbally told me; this was a verbal agreement; that he would continue to pay my insurance until the loan payment was paid, which he only paid my insurance for a year or two, and then he told me he couldn't pay it anymore because I was – I had moved out of the city. And then he agreed to pay me, that I would get my own insurance and he would pay me the difference after he had paid me for the business.

Q Didn't you also think that – didn't you also think, sir, that you were shorted approximately $16,000

out of the – out of your pension plan?

MR. DUNCAN: Objection, leading, Your Honor.

THE COURT: Overruled.

BY MR. KELLY:

Q You may answer.

A Yes, I was.

Q And the fact that you were shorted or that you felt you were shorted approximately $16,000, and –

A Plus the interest

Q Plus the interest, and you were not carried on the insurance policy, those upset you, didn't they?

A Well, wouldn't they upset you?

Q Answer the question. Didn't they upset you?

A Yes – well, I thought – I didn't think so much that he cheated me, but he lied to me.

Q Well, he lied to you. Didn't you call him up after he had had a heart attack and tell him, all right, you already had one chance, now you'd better get right?

MR. DUNCAN: Your Honor, you know, at some point it becomes badgering of the witness here.

THE COURT: Well, we're doing all right, so far.

BY MR. KELLY:

Q Isn't that true? You did do that, didn't you?

A I don't believe I ever called or talked to John.

Q You didn't do that?

A No, I didn't talk – I didn't talk – I haven't talked to John in quite a few years because –

Q So –

A Because of the money that he owed me.

Q Because – because you're upset at him, is that correct?

MR. DUNCAN: He's putting words in the witness' mouth, Your Honor.

THE WITNESS: No, I'm not upset. I'd say I was disappointed because we got along very well in business. We never had any trouble. He paid me, basically, what I was due, even though I had a hard time getting the last four payments from him. And, sure, I was disappointed because I thought I had a lot of confidence in John and I trusted him, and he let me down.

MR. KELLY: I think I have enough now to cross-examine, Your Honor. Can I proceed to cross-examine him?

MR. DUNCAN: Again, Your Honor, there's been no showing that Mr. Jasiak has been reluctant to forthrightly answer any questions here. Your Honor, the normal procedure – you know, so long as he continues to be, you know, so, apparently, forthright, I see no reason to change the rules of examination here.

MR. KELLY: Well, we're not changing the rules of examination, Your Honor. Normally, when you call a party adverse to your own party, you may cross-examine. I think this party is adverse to my – to my client. And I think, under the circumstances, I should be free to cross-examine him.

THE COURT: Well, the point where we would reach that is when – you need questions in a form that you would not otherwise be permitted to ask. And I would say, at this point, there's no demonstrated need for leading questions. I think Mr. Jasiak is answering in his own words. He's answering independently, but he is answering. So, I don't see – I recognize there's been some history between these two individuals but I think he's answering forthrightly and I –

MR. KELLY: All right.

THE COURT: – don't think he's giving you any difficulty in your examination.

BY MR. KELLY:

Q Would you please state to the Court whether or not you ever told – would you please state whether or not you ever told respondent's counsel that, yes, there was a covenant not to compete in the agreement?

A No, I didn't say that to anybody because it's not true.

Q You never said that to anybody?

A I didn't say that to anybody.

MR. KELLY: Okay, I have nothing further.

MR. DUNCAN: Your Honor, I would request that as long as Mr. Jasiak is on the stand; he is from Tucson; he drove up here today; might it be possible to go ahead and have our direct examination at this time, so that he might head home?

THE COURT: Absolutely.

THE WITNESS: Thank you, Your Honor.

THE COURT: Now, whether he's released as a witness is going to depend on both counsel's concurrence, but the idea is well conceived, at least.

MR. DUNCAN: I understand, Your Honor.

DIRECT EXAMINATION

BY MR. DUNCAN:

Q Now, Mr. Jasiak, you've been asked a lot about a supposed covenant not to compete, already. Did you and Mr. Miner ever discuss how much of your $175,000 should be allowed to a covenant?

A I don't understand that question. What did you mean "allocated to a covenant"?

Q Did you and Mr. Miner discuss whether any of the money received under the agreement should be for a covenant not to compete?

A No.

Q Okay. Did you ever discuss with Mr. Miner

how long any covenant not to compete should last?

A No.

Q Did you ever discuss with Mr. Miner the amount of territory any covenant not to compete should cover?

A No.

Q In selling your stock, did you intend that any of the money you were to receive under the written agreement should go to a covenant not to compete?

A No.

MR. DUNCAN: No further questions, Your Honor.

MR. KELLY: I have probably one more, Your Honor.

THE COURT: That's fine.

CROSS-EXAMINATION

BY MR. KELLY:

Q At the time that – at the time that Mr. Miner had a heart attack, did you send him a card, and in that card write "Now that you have been given a second chance, you'd better get right with me?"

MR. DUNCAN: Objection, Your Honor. I question the relevance of that, as to whether a covenant existed.

BY MR. KELLY:

Q Did you say that to him, sir?

THE COURT: Hold on, Mr. Kelly.

MR. KELLY: Oh, I'm sorry. Excuse me. Excuse me.

THE COURT: Overruled. You may answer.

BY MR. KELLY:

Q Did you say that to him?

A I'm a very religious man and what John did to me I put in the hands of God.

Q Would you –

A And God is the one that is going to serve for me.

Q Would you please answer my question? Did you send him a card?

A Yes, I did.

Q And you put such language in it?

A Yes, I did.

Q "Now that you have a second chance, you'd better get right with me"?

A Yes, I did.

Q All right. Thank you.

MR. KELLY: I have nothing further.

THE WITNESS: Meaning that God gave him a second chance, not me.

MR. KELLY: I have nothing further.

THE COURT: About when was that heart attack?

THE WITNESS: Oh, it was about, maybe – I heard about it, maybe, about a few months ago; three, four months ago.

THE COURT: So, this year?

THE WITNESS: Yes.

THE COURT: Okay.

MR. DUNCAN: No further questions, Your Honor. I'd ask that Mr. Jasiak be released.

MR. KELLY: No problem, Your Honor.

THE COURT: All right. You may step down and you're excused from any participation in the rest of the trial. Thanks for coming in today.

THE WITNESS: Okay. Thank you, Your Honor.

(Witness excused)

MR. KELLY: At this time, I'll call Mr. Miner, Your Honor.

THE COURT: Very well.

THE CLERK: Please raise your right hand.

Whereupon,

JOHN H. MINER,

having been first duly sworn was called as a witness herein, and was examined and testified as follows:

THE CLERK: Please be seated. Please state your name and address for the record?

THE WITNESS: My name is John Miner. My address is 7611 Calle Brisas in Tucson, Arizona.

THE CLERK: Thank you.

DIRECT EXAMINATION

BY MR. KELLY:

Q How long have you resided in Tucson, Mr. Miner?

A Fifty years.

Q And, are you married?

A Yes, I am.

Q And Holly is your wife?

A That is correct.

Q One of the petitioners in this matter. Does she reside with you at the address given?

A Yes, she does.

Q And children, do you have children?

A Yes, I have three children, three boys.

Q Are they both at home?

THE COURT: He said three.

BY MR. KELLY:

Q Three. Are they all home, or –

A One's at home, two are away.

Q Okay. Can you tell us what Cost Less Auto Parts, Inc. is?

A It's an Arizona corporation in Tucson, Arizona, started up by myself and Leonard Jasiak.

Q When was it organized?

A Nineteen seventy-four.

Q And who owned the capital stock at that time?

A My wife and I owned 50 percent, and Leonard and his wife owned 50 – the other 50 percent.

Q What business did Cost Less engage in?

A We were in the business of selling new and used auto parts at wholesalers, at discounted retail price.

Q And what do you mean by the latter?

A In Tucson. I'm sorry?

Q What do you mean by the latter, "discounted retail price"?

A Well, it's a highly competitive market and we tried to sell our parts lower than anybody else, and we felt that the mechanic – or the person walking in the door deserved the same price as a mechanic or anybody else.

Q How many location does Cost Less have?

A One.

Q Can you tell us – what can you tell us about the competition that exists in Tucson in the auto parts business?

A The competition is very keen. It's very tough.

Q Can you tell us what, generally, does it – what does it consist of?

A What does it consist of?

THE COURT: You mean who was doing the competing, or –

MR. KELLY: Yes.

THE WITNESS: Okay. Well, several different levels. I have other independent auto parts store owners in Tucson. There's probably a half a dozen. There are all your chains that you're probably familiar with in Phoenix, up here, people like Auto Zone, Check Auto. Pep Boys,

Napa, B.A.P., and they're all in Tucson. And, then, there are other people like the dealerships. There are salvage yards that sell new parts and rebuilt parts now. It's very competition, and probably in a circle of my store, there's probably 30 of those type auto parts stores, or more.

There are also people like Target, and K-Mart, and Wal-Mart, that also sell auto parts, too. So, they're directly in competition with me, too.

Q How about drug stores and grocery stores? Do they in any way compete?

A Certainly. They devote, probably, 8 to 10 square feet of that.

Q And I believe you said there are approximately 30 competitors within what radius?

A Probably a five-mile radius.

Q And how may competitors do you have in the Tucson area?

A I would say three times that amount.

Q How long were you and Mr. Jasiak co-shareholders in Cost Less?

A Since it's beginning in 1974, until it retired in December 31st, 1986.

Q Now, tell me – tell me what happened around December of 1986 with regard to Mr. Jasiak wanting to retire?

A Well, in 1986, he came to me and he said he wanted to retire, he wanted to get out of the business and that was it. Se we started negotiating.

Q And, how did the negotiations take place?

A Well, he came to me and said he wanted to sell. I looked at the books and book value was real low, and wanted to pay that. And, of course, he didn't want to pay that; he wanted more out of the company and we finally settled in or a figure of $175,000.

Q And did you go – did you see an attorney?

A Yes, we did. We saw –

Q And what attorney did you see?

A Our corporate attorney at that time, which is Doug Zirkle.

Q And is Mr. Zirkle still the corporate attorney?

A Yes, he is.

Q Did you – did you participate in the negotiations that took place – strike that. Did any negotiations take place in Mr. Zirkle's office?

A Yes, they did.

Q And who would be present?

A Leonard Jasiak, myself, and Mr. Zirkle.

Q And did those negotiations take place during the month of December 1986, or thereabouts?

A The finals did, yes.

Q And, incidentally, what status of a corporation is Cost Less?

A It's a sub S corporation.

Q Now, after you – after you arrived at the price, what did you – what did you tell Mr. Zirkle, or what was done next?

A Well, once the draft was drawn up, we got together and went over it. Now, I think he probably gave us – he gave us the drafts. We read them over and then we got together in Mr. Zirkle's office and talked about the information that was in there.

Q All right, now, you say – was it Mr. Zirkle that gave you a draft? He had prepared a draft?

A Yes.

Q In that –

A With the input that we had give to him.

Q In that draft of an agreement – strike that. Did you specifically convey to Mr. Zirkle any input that you

wanted in the agreement?

A Yes, I did. A couple items would be – well, I probably instructed him the amount, the terms, the interest rate, and also asked for a non-compete clause in there.

Q And do you recall – do you recall Mr. Jasiak conveying any input to Mr. Zirkle that he wanted in the agreement?

MR. DUNCAN: Objection, Your Honor, hearsay. That's, you know, Rule 801.

THE COURT: That's a perfectly good objection.

MR. DUNCAN: A statement other than one made by the declarant while testifying at trial.

THE COURT: Right. Is there – Mr. Kelly, do you believe it's hearsay, or if it is –

MR. KELLY: No, I don't think it's –

THE COURT: – any exception – there's any exception that applies?

MR. KELLY: I don't believe it's hearsay because I think it's a business transaction, same as a business record. He was a party to a business transaction, a conference. Mr. Jasiak –

MR. DUNCAN: Your Honor, there's no such exception.

MR. KELLY: Wait just a minute. Your Honor, I would –

THE COURT: Mr. Kelly, you can complete your statement.

MR. DUNCAN: I'm sorry, Your Honor.

MR. KELLY: I beg your pardon, sir?

THE COURT: Go ahead.

BY MR. KELLY:

Q Do you recall any input –

THE COURT: No, I mean, go ahead – excuse

me.

MR. KELLY: I'm sorry.

THE COURT: What I mean was –

MR. KELLY: Okay.

THE COURT: – go ahead with defending the question.

MR. KELLY: All right.

MR. DUNCAN: And I apologize for interrupting, Your Honor.

THE COURT: That's fine. That's fine.

MR. KELLY: Well, I don't think it's hearsay, Your Honor, not since Mr. Jasiak was on the stand saying he did not give any input into the draft of the agreement. He testified there wasn't any covenant in the draft of the agreement. And this – so I don't think this is hearsay.

THE COURT: So, you're saying – are you saying, Mr. Jasiak's testimony opened the door to –

MR. KELLY: Yes.

THE COURT: Mr. Duncan, have you considered 803-3 as an exception?

MR. DUNCAN: Well, Your Honor, then that would not be admitted for the truth of the matter if that's the exception they're relying on.

THE COURT: Well, it would. It would be admitted for the –

MR. DUNCAN: It would be just admitted to show their mental, emotional or physical condition at the time.

THE COURT: Yeah, or an intent –

MR. DUNCAN: Not the –

THE COURT: – or plan, such as whether to add a covenant not to compete. That would be an example of an intent or a plan. And the proof of that intent or plan, the proof of the existence of that intent or plan would be

admissible if 803 applies.

MR. DUNCAN: Well, I believe Mr. Jasiak's testimony wasn't, you know, it was fairly assertive that he made no such agreement.

THE COURT: Okay. Mr. Jasiak's testimony –

MR. DUNCAN: We're not talking –

THE COURT: – has nothing – Mr. Jasiak's testimony has nothing to do with where we are right now. You've made a hearsay objection to this question to this witness, and I've asked you to look at 803-3 to see whether you think that exception is available to petitioners.

MR. DUNCAN: So, the Court's suggesting that Mr. Miner is trying to reflect Mr. Jasiak's statement of mind at the time, and not whether he really said that or not?

THE COURT: What we're interested in, in all of this, is the try to reconstruct events and to reconstruct intent. Now, I recognize your primary position about whether any of this even can be considered in deciding intent, as compared to the written agreement. And we're not even – we're not talking about that right now. We're just talking about what testimony is admissible under the Rules of Evidence.

MR. DUNCAN: I understand that, Your Honor, but, again, you know, these are, you know, out-of-court statements of a declarant not under oath. So, unless there is an objection, or excuse me, exception that applies, it would be hearsay. And if the Court believes that that is a pertinent exception, then we can proceed.

THE COURT: Well, it appears that under 803-3 that a witness here in this courtroom can report on statements made by declarants out of court, as to their intent or their plan surrounding this process by which Mr. Jasiak left his co-ownership in this enterprise with Mr. Miner. If you want to respond, you may.

MR. DUNCAN: I have no further response, Your Honor.

THE COURT: All right, then, let's make sure we're all starting on the same page. Mr. Kelly, would you repeat a question, or ask a question to Mr. Miner?

BY MR. KELLY:

Q Can you tell us whether or not Mr. Jasiak in any joint conference that you had with regard to the corporation acquiring his stock, at which Mr. Zirkle was present, gave Mr. Zirkle an input as to what he wanted in the agreement?

A Yes. After the draft was done, he wanted to strike out the non-compete clause that was in there.

Q So, there was a non-compete clause in the draft?

A That's correct.

Q And, can you tell – can you tell us – you heard Mr. Jasiak testify that he started another auto parts store?

A Um-hum.

Q When was it that he started the auto parts store?

A It was before he came to me to sell; I would say at about five years prior to, or so, before he sold.

MR. DUNCAN: Your Honor, Mr. Jasiak answered and asked – or answered that question. The question has been asked and answered.

MR. KELLY: It's foundation, Your Honor.

THE COURT: Overruled.

MR. KELLY: I didn't get your answer. I'm sorry.

THE WITNESS: The answer was prior to he sold to me, I would say five, six years prior to that he opened up an auto parts store, C & E Auto Parts, which is the name

of his two children, Chris and Elizabeth.
BY MR. KELLY:

Q All right. Did the fact that he started up an auto parts store in competition with Cost Less –

A Um-hum.

Q – what effect did that have on yo with regard to – what effect did that have on you consenting to the corporation's purchase of his stock?

A Well, I was very concerned about him having a sum of money or capital that I paid him and opening up another auto parts store. He knew the business forward and backward. It's a very competitive market and, frankly, I don't even think there would be room for both of us, if we were fairly close to each other, and both of us believed that that side of town was the best side to be in as far as an auto parts store goes.

Q Now, the original agreement, or the original draft of the agreement had a covenant not to compete in it?

A That is correct.

Q And, Mr. Jasiak – what did Mr. Jasiak say about that covenant?

A Well, when we sat down for the final reading of the draft and seeing if that was okay, he object to having that in there. He said that "I will not compete with you and I give you my word." And I wanted that in there because it was so competitive and so I took his word because that was the only stumbling block that we had had. As –

Q Did he have anything to say with respect to why he didn't want it in there?

A No.

Q What were his – did he express anger?

A No.

Q Okay. Now, who else was present when he made that statement?

A Myself; the attorney, Doug Zirkle; and Leonard Jasiak; and possibly, a secretary. I don't remember.

Q Now, was there – was there any specific consideration assigned to this covenant?

A Not to my knowledge.

Q Now, how was the – how was the covenant handled for income tax purposes, if you know?

A Well, I don't think it was.

MR. DUNCAN: Your Honor, I'm not quite sure what's been asked here; income tax purposes of who or –

THE COURT: Well, I have a more basic inquiry. I don't believe that the witness has yet said that there was a covenant. And the last question assumed that there was a covenant.

MR. KELLY: All right. When –

THE COURT: So I think you need to develop –

MR. KELLY: All right. okay.

THE COURT: – a little more of the early part of the story before you go to the later part of the story.

MR. KELLY: All right.

BY MR. KELLY:

Q After Mr. Jasiak –

MR. KELLY: You're quite right. Excuse me, Your Honor.

BY MR. KELLY:

Q After Mr. Jasiak objected to this covenant, was there a second draft prepared?

A That is correct.

Q And, after that draft was prepared, and at the signing of – was the document then signed?

A That is correct.

Q At the signing of that document, please state whether or not Mr. Jasiak stated, at that time, that you had

a – that Cost Less had a covenant not to compete?

MR. DUNCAN: Your Honor, in addition to this being hearsay, it's a leading question, as well.

MR. KELLY: Not leading.

THE COURT: Sustained as to leading. As to hearsay, I think it's covered by our earlier discussion about 803-3.

MR. KELLY: I asked him to say whether or not. I didn't

THE COURT: Well, the non-leading form would be to ask what he said.

BY MR. KELLY:

Q What did he say at the signing of the agreement with respect to the covenant?

A With respect to the covenant, he said "My word is good. I will not compete with you. We've known each other for a long time," as he testified to up here. And he said "My word is good and I will not compete with you."

Q Did he assign a period of time to the covenant?

A Over the life that I was paying him back.

Q Did he tell you in what area that he would not compete?

A In Pima County or Tucson.

Q And, over what period of time were you to pay him the consideration agreed upon?

A Over seven years.

Q And did you – and did you, or have you paid him off lately?

A That's correct. I paid him everything that we agreed to.

Q Now, do you know who was your accountant at the time that this transaction was completed?

A At that time was Larry Subrin, Certified

Public Accountant in Tucson, Arizona.

Q At the closing – the transaction was closed on December 31st, 1986, was it not?

A That's correct.

Q At that time, did you believe that Cost Less had a covenant not to compete from Mr. Jasiak?

A Yes, I did.

Q Now, do you know what Mr. – is it Zerbin?

A Zirkle, the attorney?

Q No, the accountant?

A Oh, Subrin.

Q Subrin?

A Um-hum.

Q Was that your CPA?

A That's correct.

Q Do you know what he did with regard to the covenant?

A No, I don't.

Q Did there ever come a time when you obtained the advice of Mr. Bailey?

A Yes.

Q And what did Mr. Bailey advise you to do?

MR. DUNCAN: Your Honor, I'm not quite sure of the relevance of this, if they're upholding Mr. Bailey as some kind of expert, or where we're going?

THE COURT: So, let's see, relevance. What's the relevance of the question?

MR. KELLY: Well, he went to Mr. Bailey and sought his advice with regard to corporate tax matters and computation of income, and I proffer to you that Mr. Bailey advised him that there was a covenant not to compete and it ought to be amortized.

MR. DUNCAN: Your Honor –

THE COURT: The negligence issues are still

in dispute in the case, aren't they?

MR. DUNCAN: Yes, Your Honor, that is correct.

THE COURT: So do you object on relevance?

MR. DUNCAN: If all they're asserting is that Mr. Bailey suggested that they seek to take a deduction for this covenant, then I would withdraw my objection

THE COURT: Would you repeat the question?

BY MR. KELLY:

Q What did Mr. – what did Mr. Bailey advise you with respect to the covenant?

A Only that he informed me that I might have a deduction there for it, and had it been taken before and I said I didn't think so.

Q Did Mr. Bailey prepare amended corporation income tax returns for you?

A Yes, he did.

Q And those returns, do you know whether or not the covenant was amortized?

A No, I don't know.

Q Okay. Now, if you had not received a covenant not to compete from Mr. Jasiak, what would you have done with regard to requiring the corporation to purchase his stock?

A I don't think I would purchase it.

Q Why is that?

A Because it's so competitive and he knew the business forward and backwards. He was as good at that business as I was.

Q During the time that this case has been under consideration, can you tell me whether or not you were ever advised that Mr. Jasiak admitted to the respondent or agents of the Internal Revenue Service that there was a covenant not to compete?

MR. DUNCAN: Objection, Your Honor. It calls

for double hearsay. Did an agent of respondent say that a second person said, that's double hearsay; did one person say that a second person made a statement. And if there's not an exception to both parts –

MR. KELLY: Well, its certainly not because it's not – it may be hearsay, but it's an admission against interest and this was – these people were advised this by the respondent or one of respondent's agents. As a matter of fact, they were advised that by respondent's counsel.

MR. DUNCAN: And, Your Honor, I –

THE COURT: So, the question is – make sure I understand. The question is did the agent say that Mr. Jasiak said?

MR. DUNCAN: Your Honor –

MR. KELLY: During the course – during the course of the pendency of this matter.

MR. DUNCAN: Your Honor, may we go off the record for a second?

MR. KELLY: I –

MR. DUNCAN: If at all possible?

THE COURT: Yes, and anything that happens off the record, either of you can put on the record.

MR. DUNCAN: Absolutely.

THE COURT: We'll be off the record for a minute.

(Off record)

THE COURT: So, Mr. Kelly, your question is whether –

MR. KELLY: My question –

THE COURT: Just repeat your last question, if you would.

MR. KELLY: Sure. During the course of this case, were you ever advised by the respondent or any agent of the respondent that Mr. Jasiak had admitted to the

respondent that there was a covenant?

THE COURT: Don't answer yes.

MR. DUNCAN: And, again, Your Honor, for the record, if they intend to make any reference to statements of respondent's counsel, that is clearly hearsay, for which there is no objection (sic) – no exception, excuse me. And if it were not hearsay, Your Honor, then every attorney who ever interviewed a witness would be subject to testify in a case. This would be a ruling of incredible precedent if the Court allows this testimony.

MR. KELLY: Well, Your Honor, what he's stating, in fact, does happen. Lawyers can make admissions and I will proffer to you that the same testimony will be elicited from Mr. Bailey, and the same testimony will be elicited from Mr. Zirkle.

MR. DUNCAN: Your Honor, to the extent that they claim that I said that Mr. Jasiak said, you know, that's why we called Mr. Jasiak as a party, because it would be hearsay to put the person, the middleman in.

THE COURT: Well, Mr. Kelly said earlier that it was an admission. The first layer of hearsay is addressed by the state of mind rule, under 801-3, and Mr. Kelly is saying that the second level of hearsay is addressed by the admission by a party opponent, which if it fit under that rule, under 801(d)(2), it would not be hearsay.

MR. DUNCAN: Your Honor, if this testimony is admitted, then I would likely –

THE COURT: Now, just before – you don't need to speak hypothetically about whether it's admitted, but I would like you to respond to whether that addresses your double hearsay point.

MR. DUNCAN: Once again, Your Honor, I believe that state of mind is, you know, you're not getting to the truth of the matter, you know. Mr. Jasiak has made

bold statements here, you know, there was not covenant and –

THE COURT: We're just going to need to focus on this question and the objections you've raised, and the evidentiary treatment of this –

MR. DUNCAN: And what they want to do is to contradict that statement. That's what they're wanting to use this for.

THE COURT: Can you respond to the evidentiary points?

MR. DUNCAN: So far, as admissions, Your Honor, I think I would simple have to take the stand to contradict it, if necessary.

THE COURT: Can you respond to the --

MR. DUNCAN: But so far as the 803-3, I don't think that is --

THE COURT: Let me just --

MR. DUNCAN: -- why they're trying to get this into evidence.

THE COURT: I want to make this – Mr. Duncan, I want to suggest that you just stop talking for a minute.

MR. DUNCAN: Okay, Your Honor.

THE COURT: Now, what I want you to do is I'm going to take a five-minute recess, and what I want you to do is review the evidentiary principles that we've just been discussing. And, after the five-minute recess, I'd like to know your position on those evidentiary points. And I want you to consider 803-3, and 801(d)(2), or any other point that you think is relevant.

MR. DUNCAN: I'll do that, Your Honor.

THE COURT: Okay. We'll be in recess for five minutes.

(Off record)

THE COURT: Anything preliminary before we get back to the evidentiary question?

MR. KELLY: No, Your Honor.

THE COURT: All right. Mr. Duncan?

MR. DUNCAN: Your Honor, as I said before, we do object to this line of testimony on the grounds that it is double hearsay, and insofar as the 803-3 mental, you know, emotional condition, petitioners aren't trying to show a state of mind. They're trying to say that what Mr. Jasiak said so clearly on the stand is wrong. They're not – that's not the purpose they're trying to get that into. This exception does not apply in this case.

But, more importantly, Rule 613(b) says:

"The extrinsic evidence of a prior inconsistent statement by a witness is not admissible unless the witness is afforded an opportunity to explain or deny the same."

They're trying to say that a person said that Mr. Jasiak said. Mr. Jasiak is not here to explain that, now, Your Honor, so under 613(b), that's another ground why this line of testimony is inadmissible.

THE COURT: Now, you think 613(b) applies because –

MR. DUNCAN: Well, they're trying to produce extrinsic evidence of a prior inconsistent statement by a witness.

THE COURT: What's the prior –

MR. DUNCAN: They're trying to say –

THE COURT: Okay. They're trying to –

MR. DUNCAN: To say –

THE COURT: What's the prior inconsistent statement?

MR. DUNCAN: The prior inconsistent statement is it sounds like they're claiming that I had

indicated that Mr. Jasiak said that there was a covenant. That is inconsistent with what he's testified in court today. Mr. Jasiak has testified quite clearly that there was not covenant.

THE COURT: Well, this rule relates to an inconsistency by a witness, not a conflict between one witness and another witness.

MR. DUNCAN: Mr. Jasiak was a witness here, Your Honor.

THE COURT: Yes.

MR. DUNCAN: And they're trying to say that at some point, Mr. Jasiak told someone, myself, that there was a covenant. That's exactly what 613(b) talks about, Your Honor.

THE COURT: So, this is – what they're actually producing is, or what they're interested in is a subsequent inconsistent statement. The earlier testimony was regarding ~~contemporaneous~~ statement – contemporaneous to the negotiation over the sale of the stock. This, right now, is a subsequent statement which may or may not have been said, and you may or may not have repeated.

MR. DUNCAN: It might have been subsequent to some statements, but it's prior to today's statement, Your Honor.

THE COURT: Okay. Now, I see your co-counsel is back there nodding her head. Perhaps you should consult with her.

(Pause)

MR. DUNCAN: Yes, Your Honor, I mean, you know, it's the prior statement of Mr. Jasiak that they're trying to get into evidence here. And, frankly, they're trying to get it in for the truth of the matter, not for any statement of mind, or whatever. If we are just looking – if it were

purely limited to what his statement of mind was, you know, I don't know if we'd have an argument, but I can bet when we get the briefs, that they're going to argue that, you know, he said this at this time, you know. Therefore, you know, they're not looking at state of mind. They're not trying to admit it for that limited purpose of 803-3.

But, more important, it's a prior statement to today. He testified today. This is a prior statement and it's – and what they're claiming is it's inconsistent with what he said today. That's the definition of 613(b), Your Honor.

THE COURT: Okay. I see. So, you're saying that if there's going to be testimony here to the effect that Mr. Jasiak said something different than his earliest testimony, that Mr. Jasiak must be afforded an opportunity to respond and to account for the description that his testimony was inconsistent?

MR. DUNCAN: Absolutely, and from his testimony –

THE COURT: All right, then, I agree with that. I think we're going to need Mr. Jasiak back here. That would respond to your point, wouldn't it?

MR. DUNCAN: It would, Your Honor. Once, again, I would point out that they've not listed Mr. Jasiak as a witness. They knew they were going to get into this line of questioning. You know, how many surprises can we have in one trial?

THE COURT: I don't know of a limit on that. Mr. Kelly, do you want to respond to this?

MR. KELLY: Well, Your Honor, I think that – I think that this witness' testimony, as proffered, would show –

THE COURT: Let me just ask a question. Mr. Jasiak was excused from the courtroom. Do you know if he's left the area?

MR. DUNCAN: I did not see him out there.

THE COURT: All right. So – and how far – where does he live, now, in Tucson, did he say?

MR. DUNCAN: It's nearly two hours, and talking with him earlier, he had some serious concerns about night driving.

THE COURT: All right. So, if he's going to be needed for further testimony, it won't be today.

MR. DUNCAN: And he's flying out of Tucson tomorrow morning to Chicago, Your Honor.

THE COURT: And why is that, do you remember what his –

MR. DUNCAN: For his granddaughter's wedding. There's family flying in from Poland and all around the world for that. And that's why we'd requested the trial today.

THE COURT: Mr. Kelly, can you respond to the 613 point?

MR. KELLY: Well, I don't think it has application, and for this reason. If this witness' testimony as proffered, goes to the fact that you are showing the state of the mind of the parties because it's a judicial admission or an admission against interest by a proponent, that there was, in fact, a covenant in this case. I might also say that I never intended to call Mr. Jasiak. Mr. Jasiak, obviously, would not have testified favorably to my client, so it makes no sense at all for counsel to say I haven't listed him, because I would have never proposed calling him in the first place.

I think this is, clearly – I think this is clearly admissible. There's three people that heard this and all three of them are here.

THE COURT: Can you look at 613(b) for a minute, and indicate whether you believe respondent's

reliance on it is appropriate?

(Pause)

MR. KELLY: This is not a – I don't believe this is –

THE COURT: Have you read the whole thing? Why don't you just take a few minutes and look at it, and let's make sure we're all ready to do on this. I'd like to just go off the record a minute to give you a moment to do that.

(Off record)

MR. KELLY: Yes, may it please the Court, I don't think this testimony involves a prior inconsistent statement by a witness because Mr. Duncan has the opportunity to get on the stand, if he wishes, and deny the truth of this.

Furthermore, this – the provision, the provision of 613(b) does not provide to admission by a party opponent as defined in rule 801(d)(2). In Rule 801(d)(2), it talks of a statement – it talks of a statement that is offered against the party and is a statement by a person authorized by the party to make a statement concerning a subject. And that – clearly, respondent's counsel falls within that.

MR. DUNCAN: Regardless, Mr. Jasiak does not, Your Honor. The question is did Mr. Jasiak make a statement to a third person, being me, and Mr. Jasiak is not here, at this point, to have any opportunity to explain or deny the same.

You know, Rule 613 is there. Mr. Kelly should have followed it. Mr. Jasiak's been excused. That should be the end of it. But, more importantly, listening to Mr. Kelly's argument, it's obvious he's trying to get this in for the truth of the matter and he's not relying at all on the 803-3 exception. He doesn't want to rely on the 803(3) exception. He wants this in for the truth of the matter.

THE COURT: Well, Mr. Duncan, 803-3 is an

exception to the hearsay rule.

MR. DUNCAN: Absolutely.

THE COURT: If something is within 803-3, it is admissible for its truth. An example of something admissible for its truth, under 803-3, is a statement of intent or plan. An example of that would be an intent or a plan as to the contents of the contract. So, you keep going back to the 803-3 point. In my mind, we're past that.

MR. DUNCAN: But the rule says "but not including a statement of memory or belief to prove the fact remembered or believed."

THE COURT: No – right. That refers to prior – a present statement of prior intent. We're not down there is our situation here. We're above that. So, we're talking about a declarant, and that would be, perhaps Mr. Jasiak, perhaps someone else:

> "A statement of the declarant's then existing state of mind, emotion, sensation or physical condition such as intent, plan, motive."

Now, that might have been, for example, an intent to have a contract say a certain thing.

MR. DUNCAN: Respondent believes that –

THE COURT: That would then –

MR. DUNCAN: Sorry.

THE COURT: – be admissible for its truth, under 803-3.

MR. DUNCAN: Respondent believes that's an extremely expansive interpretation and renders the hearsay rule almost meaningless.

THE COURT: That point is noted. But I do agree with Mr. Duncan's final comment on 613(b), that the reference to 801(d)(2) in it, speaks to the portion of the statement that is from Mr. Duncan, but doesn't speak to the first part of the process, which is Mr. Jasiak. And it

does seem fitting and well within the purpose of 613(b) that Mr. Jasiak be presented with this inconsistency, and be allowed to respond; admit, deny, explain, whatever. That seems like that is what 613(b) is for.

I believe he's been excused by both parties.

MR. KELLY: Well, certainly.

THE COURT: So, I –

MR. KELLY: I had no reason to keep him, Your Honor. He wasn't my witness.

THE COURT: Well, we have come across a reason to have him.

MR. DUNCAN: Well, he certainly knew the line of questioning he was going to ask, Your Honor.

MR. KELLY: Well, you know, I can't help or believe that counsel didn't know it, too. He just admitted to me a while ago he thought this was all cleared up.

THE COURT: Well, it –

MR. KELLY: Obviously, it's not cleared up.

MR. DUNCAN: And, like I said, Your Honor, I thought it was all cleared up. I didn't see this coming. I had a rather lengthy –

THE COURT: When does Mr. Jasiak return from his trip to Chicago?

MR. DUNCAN: I believe he returns sometime next Thursday. At what time, I do not know, Your Honor.

THE COURT: Well, then, it seems that he's not – unless we can find some way to get him back here today – does he have a car phone? Somebody know his number?

MR. DUNCAN: I'm not aware of any, Your Honor.

THE COURT: You're not aware of any. Maybe we could take a minute and see if there's any way to contact him en route.

MR. DUNCAN: I'll – I'm not sure what those efforts would be, but –

THE COURT: Mr. Kelly, do you want to try to do that? It seems to be your need to have him here.

MR. KELLY: I wouldn't know how to begin, Your Honor.

THE COURT: All right. It appears that he's unavailable and appears that – I haven't heard you say anything on 613(b) that –

MR. KELLY: May I ask you what would be wrong in taking his deposition? Let respondent depose him and submit the deposition to the court?

THE COURT: Mr. Duncan?

MR. DUNCAN: Your Honor, I have several questions as to that. First of all, you know, this is when trial is set. Second, you know, who is going to bear the cost of this?

THE COURT: Mr. Kelly, who is going to bear the cost?

MR. KELLY: Yes, we'll bear the cost.

MR. DUNCAN: Third, you know, Mr. Jasiak has testified so clearly today. And fourth, Your Honor, if the Court determines, you know, consistent with what respondent's theory in the original motion for partial summary judgment, then all this testimony should not be considered anyway. As respondent's primary theory of the case is that the document is so clear in itself, that no extrinsic evidence should be necessary, you know, and especially none that contradicts or varies it should be considered.

And, you know, plus, Your Honor, as the Taylor case indicated, you know, the Court considers the evidence, but at some point, you know, there comes a point that it's not necessary to hear anymore testimony that black is white,

or that night is day, that you can cut off testimony at that point as to – under the Arizona version of the parole evidence rule. Taylor did not suggest that the Court needs to consider everything that a party wishes to offer that might contradict or vary an agreement.

Furthermore, Your Honor, I think that the Court, you know, the reason that the Judge is here is in order to see the witness' credibility and that's one of the reasons that we don't do trials by deposition. I believe Mr. Jasiak would be an incredibly credible witness, but the Court wouldn't be able to get that from just the cold record.

THE COURT: Well, Mr. Kelly, you may, at the end of the trial, make a motion for a deposition, and I would give Mr. Duncan an opportunity to file a response to that, and then I can rule on that motion. I'm not going to do that now. What I am going to do now is say that I've not seen you give any consideration that overrides the points he makes on 613(b), and so under 613(b), given that Mr. Jasiak is unavailable to us in this trial, I will sustain his objection to your question.

MR. KELLY: May I make a proffer, because I have three witnesses here, today, that will testify to this. And can this be received in as a proffer?

THE COURT: Yes. In fact, you can ask the question to the witness and I will just indicate that I won't consider it in deciding the case.

MR. KELLY: Okay. Do you remember the question, Mr. Witness?

THE WITNESS: No. Would you repeat it, please?

BY MR. KELLY:

Q During the course – during the course of the consideration of this case, were you ever present or advised by the respondent or any agent of the respondent, that Mr.

Jasiak had admitted to the respondent that there was a covenant not to compete given to Cost Less?

A That is true.

Q Where did that occur?

A I think it was about November of last year. It was Doug Zirkle and myself, and Don Bailey; had a meeting with John Duncan at the IRS office up in Phoenix, and he invited us up into a conference room and sat down, and they had several issues they wanted to talk about. And, first off, John said that he spoke to Leonard Jasiak, and Leonard Jasiak felt that there was a covenant not to compete in the agreement, was his words.

Q So, he told you, at that time, that Mr. Jasiak had told him that there was a covenant?

A That is correct.

Q When you – now, do you know how long Mr. Jasiak was in Tucson after the close of the transaction on December 31st, 1966?

A No, I do not.

Q Do you know how long he worked for Cost Less?

THE COURT: Let me just – just for the record, you've now complete the question –

MR. KELLY: Yes, I have.

THE COURT: – related to what we were just discussing?

MR. KELLY: Yes, I have. Sorry, Your Honor.

THE COURT: So, that answer, I won't consider in deciding the record, per my prior ruling. But, from now on, we're back to where I would consider the answers. I just want the record to be clear and we'll have to go through and exercise, similar to that, with the other two witnesses.

MR. KELLY: Sure.

BY MR. KELLY:

Q Can you tell me about how long he worked – how long Mr. Jasiak worked for Cost Less?

A It seemed like it was a year, year and a half that he worked at Cost Less, off and on, just randomly came in and no set hours.

Q Now, what is your – can you tell me what your present standing is with Mr. Jasiak?

A Not as good as it was before; disagreeable.

Q And, are you on friendly terms?

A No, I am not.

Q Can you tell us why you are not?

A I think it results from, or is a result of the pension plan that we had with Cost Less Auto. Prior to his retiring, we got together with the actuary and they recommended so that he could take the maximum number of money out of the pension plan, that we rewrite our plan to a defined benefit plan. We rewrote it, and signed it, and agr3ed upon it. After his retirement, the plan took about a year before they computed how much was due everybody. He was the only one had retired or quit, so they calculated his amount of money.

They told me the amount and I wrote the check for that amount and gave that to him. I guess he had several conversations with them regarding that. They told him that he got what was deserving of him, based on his vesting. And he felt that should be a higher number, about $16,000 more, because had prior knowledge to the confidential documents that they give to the owners. And he was looking for that number.

Q So did he become upset about that?

A Yes, he did.

Q You heard his testimony about the insurance?

A Yes, I did.

Q And can you tell us about that?

A Yes. We had agreement. I maintained him on the insurance. When he moved to Lake Havasu, he put a claim in with the insurance company and they wrote me a letter canceling him and denying him insurance because he was out of the service area.

Q Did he become upset about that?

A Yes, he did.

Q Now, how many – how big is the inventory in number of different parts is the inventory of Cost Less?

A Number of parts? About 75,000

Q And how do you maintain an inventory of that many nuts and bolts, so to speak?

A We have a computer that keeps track of it.

Q And, is there anything unusual about the program that you use?

A Yes. The program works kind of like your opening statement. We have parts on the shelf and every time we get a price change, we change the price of the parts so that the parts that are on the shelf are valued at a higher value.

Q So when it changes – when it inputs the cost of a

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years, so maybe it might be '92 or '3.

MR. DUNCAN: No further questions, Your Honor.

MR. KELLY: I have nothing further.

THE COURT: You may step down, Mr. Miner. Thank you for your testimony.

(Witness excused)

MR. KELLY: At this time, I call Mr Zirkle.

THE COURT: Very well.

THE CLERK: Please raise your right hand.

Whereupon,

RAYMOND D. ZIRKLE,

having been first duly sworn was called as a witness herein, and was examined and testified as follows:

THE CLERK: Please be seated. Please state your name and address for the record, and please spell your name.

THE WITNESS: It's Raymond, R-a-y-m-o-n-d, Douglas, D-o-u-g-l-a-s, Zirkle, Z-i-r-k-l-e.

MR. DUNCAN: Your Honor, I believe a housekeeping matter might be necessary at this point, as Mr. Zirkle might be testifying as to matters in which he represented a client. I would believe that it would be appropriate for a representative of Cost Less to waive the attorney/client privilege, just to make it clear that, you know, that those are open matters here.

THE WITNESS: Yes, Your Honor. I was going to ask that anyway. Mr. Miner, I believe, is still President of Cost Less.

MR. KELLY: We waive all – we will waive the attorney/client privilege for Cost Less.

THE WITNESS: Okay. Where am I –

THE COURT: Is that satisfactory, Mr. Duncan?

MR. DUNCAN: Yes, Your Honor.

THE WITNESS: D-o-u g-l-a-s, Zirkle, Z-i-r-k-l-e. Do you want my residence or business?

THE COURT: Office is fine.

THE WITNESS: It's 2701 East Speedway, Suite 200, Tucson, Arizona, 85716.

THE CLERK: Thank you.

DIRECT EXAMINATION

BY MR. KELLY:

Q What is your trade or occupation, Mr. Zirkle?

A Attorney.

Q And, where did you graduate from law school?

A Indiana University.

Q And, do you practice law?

A Yes, I do.

Q And, were do you practice?

A Tucson, Arizona.

Q And what is the nature of your practice?

A I do corporate business construction and if it's big enough, I'll do domestic work.

Q Do you represent a corporation by the name of Cost Less auto Parts, Inc.?

A I have in the past, and I assume I still do. I haven't done much work in the last few years for them.

Q And –

A I'm still statutory agent, so I guess I am.

Q How long have you – when did you start representing them?

A I believe it was back in the middle of 1975. I was just going though my file and saw something for middle of July '75, or so.

Q Did you know who the shareholders were?

A Yes.

Q And who were they?

A John Miner and Leonard Jasiak.

Q Where they both the co-shareholders during the time that you represented them, up until the end of 1986?

A It would have been up until the time that Mr.

Jasiak sold his interest in the corporation. Yes, they were both the shareholders.

Q In nineteen-eighty – the latter part of 1986, were you ever informed that Mr. – by Mr. Jasiak that he wanted to withdraw from the corporation?

A I'm not sure who informed me, but it came to be that Mr. Jasiak did want out of the corporation and wanted his shares purchased.

THE COURT: Before you look at your documents – don't look at your documents yet, sir.

THE WITNESS: No, I was just trying to get the file.

THE COURT: Well, just –

THE WITNESS: I assume it was in '86. I believe it was Sometime in '86.

BY MR. KELLY:

Q Well, it's been stipulated in this case that there was an agreement entered into on December 24, 1986, between Mr. Jasiak and Cost Less, concerning the purchase of Mr. Jasiak's stock by the corporation. Does that ring a bell?

A If that was the date, that was the date, yes.

Q Do you recall – do you recall any negotiations leading up to that agreement between Mr. Jasiak and Mr. Miner?

A Well, do I recall specific instructions? No, but I know that they did tell me how they wanted to structure the particular buy-out, and based upon what they told me, I prepared some documents.

Q Did you receive instructions both from Mr. Miner and from Mr. Jasiak, do you recall?

A All I could tell you is, normally, that's the way things would go in that type of situation, and then when the document was prepared, it was presented to the

corporation and to Mr. Jasiak for their review.

Q Mr. Miner and Mr. Jasiak?

A Right, what I mean, the corporation, since it was the corporation that I was representing at the time.

Q I take it you did prepare a document, then?

A Yes.

Q And did you present a copy of that document to the shareholders?

A Yes.

Q And was it the subject of discussion in your office?

A Well, I'm sure it was discussed because there was more than one draft prepared.

Q When you did the first draft, what happened?

A Well, I prepared the first draft according to what they had told me and sent it out, stated it was a draft and sent it out for their review.

Q And, did you get any feedback back?

A I got some reply back on some changes that they wanted to make to the first draft, yes.

Q And what were the changes they wanted to make, if you recall?

A Well, in particular, the first draft had a covenant to compete in there. And the second draft did not have a covenant not to compete.

Q And, why is it the second draft did not have a covenant not to compete?

A Because Mr. Jasiak was insulted that it was in writing in the covenant, and that he had given his word to Mr. Miner and/or the corporation that he was not going to compete, and he thought that should be good enough.

Q All right, now – and after – was that a conversation that you had with Mr. Jasiak in front of Mr. Miner?

A I don't know whether it was in front of Mr. Miner or not, but I particularly remember Mr. Jasiak being insulted and indignant about that because Leonard was – he was a high man of principle and he thought – he was a person who said his word was his word. And you only push so far when you're advising clients and both of them said no, leave it out. So I left it out and prepared the final draft in the form that, I assume, that you've introduced today.

Q What happened – what happened to the covenant?

A It was – it was taken out of the first draft and was not in the final draft.

Q Can you state whether or not an oral covenant was put in place?

MR. DUNCAN: Objection, Your Honor. Calls for hearsay.

THE COURT: Mr Kelly?

MR. KELLY: Well, I don't think it is hearsay. We're right back to the – we're right back to the same position. You have a business transaction being conducted by an attorney on behalf of a corporation, between two shareholders, and this is part of the total transaction, so I don't think it is hearsay. I think it's an exception to hearsay.

MR. DUNCAN: I would ask which exception, Your Honor. We have, you know – you know, oral statements between two persons, essentially, is what's being asked.

MR. KELLY: Well, the same questions were asked of Mr. Miner and the Court admitted it under, I believe, 803. And the same reasoning applies here.

THE COURT: Well, the question is whether something was put into place.

MR. KELLY: Well, was there –

THE COURT: That's not – you're not within the terms of 803-3.

MR. KELLY: Well, maybe the question was in bad form. Perhaps the question was in bad form. I can restate the question, but I think as to whether or not there was an existence in an oral covenant between Mr. Jasiak to the corporation, is appropriate for this man to answer, this witness to answer.

THE COURT: It may be, but I don't think you've asked the question yet.

MR. KELLY: Okay.

BY MR. KELLY:

Q Can you state to the court whether or not there was an oral covenant not to compete running from Mr. Jasiak to the corporation, Cost Less?

A Mr. Jasiak's –

MR. DUNCAN: Your Honor, in addition to requesting hearsay, that's a conclusory question, calls for a conclusion, as well, without any background.

THE COURT: I think it might be better to ask this witness to just tell what he knows and start from the beginning and just do it in narrative form.

MR. KELLY: Well, I thought we had. But go ahead and tell –

THE COURT: It's going to take a couple minutes. I don't mean it's going to take all night, but you can probably do it in a few sentences.

MR. KELLY: Tell the Court –

THE WITNESS: On brief.

THE COURT: I think it's better if it comes in the witness' words.

BY MR. KELLY:

Q Tell the Court how the transaction was

conducted, how the covenant was removed, et cetera.

A Okay. The original draft, first draft which I prepared, had a covenant not to compete in it where Mr. Jasiak, who had run an auto store before, in Tucson, Arizona, agreed not to compete with Cost Less Auto Parts in – I believe it was in Pima County – Pima County, Arizona. The draft was presented to both parties to the agreement. Mr. Jasiak agreed that he was not going to compete. But, as I said, he was insulted because that particular term was in there, being of a high – he felt that his word was good enough. He's from an old Polish family and, therefore, he was indignant, the fact that that was in there, and that is an unusual situation and that's why I remember that particular indignation.

But he said, "Yes, I will not compete, and that's part of the agreement, but I will not sign . . ." In fact he said he would not sign the agreement with the covenant in there because he felt insulted.

BY MR. KELLY:

Q Was there a covenant existing between Mr. Jasiak and Cost Less?

A To my understanding, yes, there was.

Q And it was for Pima County, Arizona.

A Yes. A minimum of Pima County, Arizona. It may have been larger but I don't know why it would have been larger.

BY MR. KELLY: I want to make a proffer to the Court, at this time, through your testimony, all right?

BY MR. KELLY:

Q During the course of the consideration of this case, were you ever advised by the respondent or an agent of the respondent that Mr. Jasiak had admitted to the respondent that there was a covenant not to compete existing in favor of Lost Less auto Parts, Inc.?

MR. DUNCAN: Your Honor, just for the record, I want it made clear that we object to this testimony on the grounds stated in Rue 613(b), as well as all of the other concerns stated when similar testimony was proffered from Mr. Miner.

THE COURT: Well, Mr. Kelly, I think, fully acknowledges your pont and he's asking this an an offer, directly from the witness, and so I think you've stated that properly, Mr. Kelly. And,, per our prior discussion on this, I will not consider this in deciding the case, but I think Mr. Kelly is entitled to preserve the issue.

MR. DUNCAN: Thank you, Your Honor. I just wanted to make that clear.

THE COURT: That's fine.

THE WITNESS: I could better answer the question referring to my notes that I took.

MR KELLY: You may refer to your notes.

THE COURT: Well, now, just a minute.

THE WITNESS: During my –

THE COURT: Before you look at your notes, I'd like you to answer to the best of your ability.

THE WITNESS: Well, I reviewed my notes ahead of time and there are indications in my note that the only question is whether or not the parole evidence rule prohibited the covenant from – from evidence of the covenant being introduced into court.

BY MR. KELLY:

Q Was there ever a time when you – that you were present when the respondent or the agent of respondent admitted that Mr. Jasiak had admitted to the respondent or to one of his agents, that there was a covenant not to compete running in favor of Cost Less Automobile – or Cost Less Auto Parts, Inc. from Mr. Jasiak?

A I would say yes.

Q And where did that occur, sir?

A It would have been in the offices of the Internal Revenue Service Counsel. I can't remember exactly where it is in town. We had two meetings there.

Q And, approximately when?

A Well, I can tell you exactly when. It was October 2nd, 1997.

Q And who was present, sir?

A I was present, Mr. Miner was present, Mr. Duncan was present, and Mr. Bailey was present. In fact, it was 11:00 a.m. when the meeting occurred – started.

MR. KELLY: I have nothing further.

MR. DUNCAN: I have nothing for this witness, Your Honor.

THE COURT: Thank you, Mr. Zirkle, you may step down.

THE WITNESS: You don't need me anymore, I hope.

(Witness excused)

MR. KELLY: You may be excused, Mr. Zirkle.

MR. DUNCAN: That's fine with me, Your Honor.

THE COURT: You may leave the court area.

MR. KELLY: Call Mr. Bailey.

THE COURT: Very well.

THE CLERK: Please raise your right hand.

Whereupon,

DON BAILEY,

having been first duly sworn was called as a witness herein, and was examined and testified as follows:

THE CLERK: Please be seated.

THE WITNESS: Thank you.

THE CLERK: Please state your name and address for the record, and please spell your name.

THE WITNESS: Don Bailey, B-a-i-l-e-y. And my address is 2343 East Broadway, B-r-o-a-d-w-a-y, Suite 107, Tucson, Arizona 85719.

THE CLERK: Thank you.

DIRECT EXAMINATION

BY MR. KELLY:

Q Mr. Bailey, what is your trade or occupation, please?

A I'm a CPA, Certified Public Accountant in the State of Arizona.

Q And were do you practice?

A At 2343 East Broadway, Suite 107, Tucson, Arizona.

Q And when did you commence – when did you become a CPA?

A I believe it was March 1983.

Q And, prior to that time, in what business or profession did you engage?

A I did the same, accounting and tax work.

Q Do you hold any degrees, college degrees?

A Yes, I do.

Q And from what University?

A University of Arizona.

Q And, what degrees do you hold?

A I have a bachelor of science – let's see, a bachelor of science in business administration, and a bachelor of science in accounting. And I have a MBA, and I have – excuse me, I've got a bachelor of arts in government, spanish and speech. I have enough hours for the bachelor of science in business administration but I haven't applied for it yet. So, I have only three degrees, almost four.

Q And have you done any work on a masters in taxation?

A Yes, I have about half the hours for a degree in masters in taxation.

Q Now, do you know Mr. Miner?

A Yes, I do.

Q And how is it you know him?

A He called me and wanted me to take a look at his business and personal taxes.

Q And can you tell us when you first – when were you first contacted by him?

A I believe it was probably September, October of '93.

Q And have you –

A Somewhere in that area.

Q – represented him since that time?

A Yes, I have.

Q For your information, Mr. Bailey, the amended corporate income tax returns for Cost Less are Exhibits 9-J, 1-J and 11-J, and anytime you'd like those, why, they can be furnished to you, okay?

A Okay.

Q Can you tell me what business Mr. Miner was in?

A He's in the auto parts business.

Q And, when he contacted you, what was the purpose of his contact?

A He wanted to complete – finish his personal and corporate taxes for several years.

Q And did you commence work on that project?

A Yes, I did.

Q In the course of that project, did you prepare the amended returns that I just referred to as 9-J through 11-J?

A I'm not looking at them but I'm sure I did.

MR. KELLY: May I have those exhibits,

please, 9-J through 11-J? They're in the stipulation. Could they be furnished to him at this time, Your Honor?

THE COURT: Yes. I believe we have two copies because they were in both versions of the stipulation.

(Pause)

BY MR. KELLY:

Q Now, Mr. Bailey, are those the amended returns that you prepared?

A Yes, I did.

Q At such time as you were completing the preparation, or immediately prior to that, was there an income tax investigation started?

A Well, what happened, John had not filed the tax returns and so Dennis Machado had contacted him and wanted him to file his personal tax returns, I think, for about three or four years. And, that's correct, yes.

Q And in connection, did you prepare the corporate returns at that time?

A Yes.

Q Or were you preparing them?

A I was working on those, yes.

Q And did you also prepare the personal returns?

A Yes, I did.

Q And, what was the agent's name, again?

A Dennis Machado.

Q And did Mr. Montado (sic) –

A Machado.

Q Are the adjustments that were made by the agent made to the amended returns, corporate returns that you prepared?

A I don't think all of the adjustments that – I think some of them were, and some of them weren't. I

think that the original – when I originally did the amended returns, I think they were based on – I thought that the accountant had made a mistake and he was on the accrued basis and it should have been on the case basis. And I think – and then it wasn't later until the adjustments that we appealed finally came to fruition.

Q Now, when you prepared those returns, did you give any consideration to a covenant not to compete running from a Mr. Jasiak?

A At the time I did those returns, the covenant not to compete had not come up.

Q Well, did you give any consideration to it?

A I did, later, when we got into the audit, yes.

Q And, as a result of – who did you talk to about it?

A Well, when John and I got in the – when Dennis Machedo picked up the amended corporate returns and he wanted to audit them and look at them. And then we started going through the records, and so forth and so on, and that's when the covenant not to compete came up because in the equity section, the prior accountant had stuck an item for $175,000 in it, and I asked John what that was for. And then we started talking about the purchase and the terms and conditions of the covenant, and so forth, purchase of the agreement and the terms and conditions of it. And that's when the covenant not to compete came up, and John said there was a covenant.

Q Now, and these conversations occurred between you and Mr. Miner?

A Yes.

Q And, as a result of those conversations, did you give him any advice with regard to the covenant?

A Well, I said if he had a covenant, he could write it off over a certain period of time.

Q And, what did you recommend?

A Well, I wanted to get a copy of the contract and, also, contact the attorney who wrote the agreement between the two parties.

Q And did you do that?

A I did.

Q And what did you find?

A Well, I talked to Zirkle, and he gave me a letter stating that there was a covenant between Jasiak and between Miner.

Q And, did it say anything further?

A I think it was for a period of seven years, he thought, and I think, at that time, that's all - all that was said.

Q For what area did it cover?

A I thought it was either Pima County or it was seven miles radius from the store, or I'm not sure exactly the coverage of it.

Q And on the basis of that, did you make any recommendations to Mr. Miner?

A Well, I though we could amortize it over the life of the covenant, the life of the note, which was the value of the covenant.

Q And, did you do that?

A Yes, I did.

Q And, what was the amount of the amortization that you took?

A Twenty-five thousand dollars per year over the life of the covenant, which was seven years.

Q And, in doing that, what did you rely upon?

A I relied upon John Miner's word, and especially the attorney, Zirkle.

Q Did you look at any prior year returns?

A Yes, I did.

Q And what was the – can you tell us what was the consideration, if any, was given to the book value of the company?

A Well, at the –

MR. DUNCAN: Your Honor, we don't have any kind of evidence of book value or anything like that here.

THE WITNESS: Well, I think we do. We have the –

THE COURT: Hold on just a second. Mr. Kelly?

MR. KELLY: Would you mark these for identification, please?

THE CLERK: Petitioner's Exhibit 17-P marked for identification. Petitioner's Exhibit 18-P marked for identification.

(The documents referred to were marked for identification as Exhibit 17-P and 18-P)

THE CLERK: Do you have another copy sir, to give to the witness?

MR. KELLY: No, I don't. I don't think.

THE WITNESS: I've got a copy of it.

MR. KELLY: You've got it?

THE WITNESS: Yeah, I've got a copy. That's '86 and '87.

MR. KELLY: Yes.

THE COURT: Did you give a copy to Mr. Duncan?

MR. KELLY: I'll have to give – do have copies of these, sir?

THE COURT: Do you know what we're talking about yet, Mr. Duncan?

MR. KELLY: You have them, don't you?

MR. DUNCAN: I don't know what he's talking about yet, Your Honor.

THE COURT: Okay. There's an 1120S for 1986 for Cost Less. There's a 7004 for Cost Less.

THE WITNESS: That's the copy of the extension on top. Underneath, it's the corporate tax return.

THE COURT: An '87, 1120 S for Cost Less.

MR. DUNCAN: For '87, I would likely have a copy somewhere in this stack of stuff, Your Honor. For '86, I doubt it.

THE COURT: Well, they're not admitted into evidence yet, but I think you're going to want to have them in front of you –

MR. DUNCAN: Absolutely, Your Honor.

THE COURT: – For purposes of discussion. If you don't have copies, you can look at these before the witness does. If you do have them, things will go faster.

MR. DUNCAN: I'm almost certain we don't have '86, Your Honor.

THE WITNESS: He can have my '86. I know what's on it, unless you want me to look at it.

THE COURT: Okay, then, that's great.

THE WITNESS: Okay. Here.

THE COURT: That's a big help.

MR. DUNCAN: May I approach, Your Honor?

THE COURT: Oh, yes. That's one of the two; that's the '86. Oh, and the '87 you thought you might have?

MR. DUNCAN: I'm told – Your Honor, I'm told that we do have a copy of 1987.

THE COURT: All right.

BY MR. KELLY:

Q Now, I've referred you to Exhibits –

THE COURT: 18-P is '87, and 17-P is '86.

MR. KELLY:

Q I referred you to the 1986 and 1987 returns

of Cost Less.

A That's correct, corporate tax –

Q *Exhibits for identification?*

A Corporate tax returns, yes.

Q Did you, in considering this covenant and the advice that you gave to Mr. Miner, did you review those documents?

A Yes, I did.

Q For what purpose?

A Just to see how correct they were.

Q Did you give any consideration to the book value of the corporation?

A Well, at that time, the book value of the corporation was just a little over $10,000.

Q Is that true for both 1986 and 1987?

A It was –

MR. DUNCAN: Your Honor, I'd like to know where he's getting that 10,000 number from.

THE WITNESS: Well –

THE COURT: Well, if he's getting it from the return, it's not in evidence. So it's not available to him as a source, and since he has the return in front of him, I think that's where he's getting it. So would you like to move these items into –

MR. KELLY: I move they be admitted, Your Honor.

THE COURT: Both of those exhibits. Is there an objection?

MR. DUNCAN: No objection, Your Honor.

THE COURT: Then they are admitted.

(The document referred to, having been previously marked for identification as Exhibits 17-P and 18-P, was received in evidence.)

THE COURT: Now if you could tell us where you are in the exhibit?

THE WITNESS: Where I got – are you asking where I got the book value? Well, look on the balance sheet, the equity section.

THE COURT: And you're on the '86 return?

THE WITNESS: YES, '86. Look on eighty – it's about the third page over. One more.

THE COURT: Okay.

THE WITNESS: If you'll look at the equity section there's $10,000 worth of capital stock and, then, they've shown accumulated adjustment of $227, and it's a little less than $10,000.

MR. DUNCAN: Could you tell me which –

THE COURT: He's on Schedule L.

MR. DUNCAN: Okay.

BY MR. KELLY:

Q Is that the '86 return or the '87 return?

A Eighty-six.

THE COURT: And he started with line 21.

THE WITNESS: Yeah.

THE COURT: Schedule L.

THE WITNESS: Line 21, yes, Schedule L.

Q And on –

A So the book value is, roughly, about $10,000.

Q And on the basis of that –

THE COURT: Now, wait. Wait just a minute.

MR. DUNCAN: Your Honor, I –

THE COURT: Mr. Duncan, are you up with him now?

MR. DUNCAN: I can see where they're coming from. I'm not so sure than line 21 represents what he claims it does, capital stock. I wold be more inclined to think that that most likely represented par value or some

other item.

THE WITNESS: Well, it represents 10,000 shares of stock.

MR. DUNCAN: That one dollar par would be $10,000 par?

THE WITNESS: That's right. That's right. That's all it is.

MR. DUNCAN And, Your Honor, par value of stock is far different from book value, so if that is –

THE WITNESS: Book value by definition –

THE COURT: Wait just a second, sir. Go ahead, Mr. Duncan.

MR. DUNCAN: If that's how Mr. Bailey determined book value, then we have a real problem here.

THE COURT: What's the problem?

MR. DUNCAN: Well, as I said, par value and book value are two totally separate things and if he took par value to beat book value, then we're talking apples and oranges.

THE WITNESS: Okay, what's the difference?

THE COURT: Just a second, sir. What the difference between the two?

MR. DUNCAN: Well, par value, Your Honor, is just the value that the parties put on a stock when it's first issued. You put in the corporate documents that stock has par value of $5 per share. It might eventually become worth $100 per share, but it's forever going to have a par value of $5 per share. Par value and book value are two totally separate things. And par value usually tends to represent the amount of capital paid in at the time of incorporation. Sometimes the parties play fast and loose with that, but I think that's what the intent of the law is for par value.

THE WITNESS: Well, the –

THE COURT: Okay, now –

THE WITNESS: Go ahead.

THE COURT: – Mr. Bailey, would you like to respond to what Mr. Duncan just said?

THE WITNESS: Well, first of all, there is no difference between par value or no value, and $1 value. There is no difference. I mean, it's still $10,000 and the total value of the stock is worth a dollar per share. That's what it is. By definition, that's the book value of the stock. Now, the fair market value of the stock may be much different than the book value of the stock. You know, it could be $1,000 a share. But right here, the book value of the stock is roughly about $1 per share, divided by –

MR. DUNCAN: Your Honor, may I just ask a couple questions on voir dire?

THE COURT: Yes.

VOIR DIRE EXAMINATION

BY MR. DUNCAN:

Q So, where does this one dollar per share value

come from?

A It – well, it –

Q Who designates it or –

A Well, by definition, they've got 10,000 shares of stock. It's worth $1 per share.

Q According to?

A Look at the – look at the incorporated papers. It's one par value, one dollar.

Q So, this is according –

A It's worth $10,000.

Q Okay.

A You can't push it either way.

Q Okay, so this comes from the incorporation papers?

A That's correct.

Q Fine, thank you, Your Honor.

THE COURT: You don't mean it's worth $10,000?

THE WITNESS: No, that's book value.

THE COURT: Okay.

DIRECT EXAMINATION (RESUMED)

BY MR. KELLY:

Q How do you determine book value, Mr. Bailey?

A Well, you go top the equity section –

MR. DUNCAN: Asked and answered. He already said that he determined it from the corporate – incorporation papers, Your Honor.

THE WITNESS: No, I said the value of the stock which is, if you'll read the corporation papers, will tell you it's worth $1 per share, par value. That's where you get the par value. You asked me that. I told you. Was that a question or an answer?

MR. KELLY: May I proceed, Your Honor?

THE COURT: Yes.

BY MR. KELLY:

Q How do you determine book value, Mr. Bailey?

A Well, book value, you generally take the – in a corporation, you take the total number of outstanding shares and add up the capital stock paid in, or capital surplus and retained earnings and divide it by the total number of outstanding shares, and that will give you the book value per share. And then you multiply that times the total number of shares outstanding and that will give you the book value of the whole corporation.

Q Is there another way of doing book –

A I don't know any other way.

Q How about taking into consideration assets less liabilities?

A That's –

MR. DUNCAN: Asked and answered, Your Honor. He's already said he doesn't know another way.

THE WITNESS: There's only one way to answer. There's only one way to determine it. How else is there?

BY MR. KELLY:

Q And the book value of this corporation in '86 was what?

A The end of '86 is roughly $10,000.

Q And what was the book value of the corporation in '87?

MR. DUNCAN: – I'd ask where he's coming with that $10,000 number? Is that the line 21 number he's referring to?

THE WITNESS: Wait just a second. Do you want me to answer his question or yours?

THE COURT: Well, I don't want you to – either one, right now.

THE WITNESS: Okay.

THE COURT: The $10,000 figure is 10,000 times one dollar, and one dollar is contained in the corporate charter, did you say?

THE WITNESS: That's correct. If you'll look –

THE COURT: Thank you.

THE WITNESS: Okay.

THE COURT: You just gave the method for computing book value.

THE WITNESS: Okay.

THE COURT: Okay. You didn't say you looked at the corporate charter and copied down the number from it.

THE WITNESS: Somewhere I saw a dollar par

value. Somewhere.

THE COURT: Okay. No, what I'm saying is, I'm just sitting here listening to your –

THE WITNESS: Okay.

THE COURT: – to your testimony. The way you got the $10,000 is not the way you get book value, right?

THE WITNESS: Well, book value of the par – of each share of stock is determined by taking the retained earnings, everything of retained earnings, and capital stock, and dividing it by the total number of outstanding shares.

THE COURT: Okay.

THE WITNESS: That gives you your book value per share.

THE COURT: And you –

THE WITNESS: That gives you your book value per share.

THE COURT: And you –

THE WITNESS: In this case, there were 10,000 shares. It was, roughly, one dollar. The book value of the corporation has to be 10,000. It can be nothing else.

THE COURT: But you got this 10,000 by looking at corporate chart, and multiplying one dollar times 10,000?

THE WITNESS: No, but I – John had 5,000 shares and Jasiak had 5,000 shares.

THE COURT: Um-hum.

THE WITNESS: That's were I got my 10,000.

BY MR. KELLY:

Q And did you, then, ultimately, did you recommend to Mr. Jasiak that he amortize or –

A Mr. Miner, you mean?

Q I mean Mr. Miner, that he amortize or deduct

a certain amount of the covenant for over the years in question?

A Yes, I did.

Q And that amount was what?

A $25,000 per year over the life of the note, which is seven years.

Q And did he rely on that advice?

A Yes, he did.

Q Now, I want to make a proffer to the Court of certain testimony that I think you would testify to if it weren't in the form of a proffer.

During the course of the consideration of this case, were you ever present at a conference whereby an agent of the respondent, or the respondent admitted that Mr. Jasiak had admitted to him that there was a covenant not to compete running from him, in favor of Cost Less Auto Parts, Inc.?

A Yes, I was.

Q And where did that – where did that take place?

A That took place at 210 Earll in Phoenix.

Q In whose office?

A Well, we were up in John Duncan's office.

Q And who was present?

A John Duncan, Doug Zirkle, John Miner and myself.

Q And who made the statement?

A John Duncan.

Q And, approximately when was the statement made?

A I'm trying to remember. It seemed like it was about the end of July or the first of August, or somewhere in that area of '97.

Q Okay. Now, when you prepared – when you

were preparing these amended returns, did you become aware, in your discussions with Mr. Miner, concerning a problem with the inventory?

A Yes.

THE COURT: Now, you're at the end of the proffer?

MR. KELLY: The proffer, yes. Excuse me, Your Honor. I'm sorry.

THE COURT: All right. That's fine.

MR. KELLY: The proffer is concluded.

BY MR. KELLY:

Q Did you become –

A Yes.

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drive back to Phoenix, if that can be avoided, but – all right. Go ahead.

MR. DUNCAN: Your Honor, I'd call Dennis Machado to the stand.

THE CLERK: Please raise your right hand.

Whereupon,

DENNIS MACHADO,

having been first duly sworn was called as a witness herein and was examined and testified as follows:

THE CLERK: Please be seated. Please state your name and address for the record, and please spell your name.

THE WITNESS: Dennis Machado, 300 West Congress, Tucson, Arizona.

DIRECT EXAMINATION

BY MR. DUNCAN:

Q Mr. Machado, where are you presently employed?

A With the Internal Revenue Service, Tucson.

Q And do you know the petitioners?

A From having had contact with them in the course of my business.

Q Okay.

A My job.

Q And, when did you first find it necessary to contact them?

A Around October 1993.

Q And what were the circumstances.

A Mr. and Mrs. Miner had not filed their 1987 '88, '89' '90, '91 and '92 tax returns for their personal business – I mean, for their Form 1040, their individual tax returns.

Q And, I'll jump ahead a little bit here. You've heard the testimony about their corporation, Cost Less, and the $10,000 inventory adjustment. Are you familiar with that issue?

A Yes.

Q And that was discussed during your examination?

A Yes.

Q And, you disallowed their claim for 1987, is that correct?

A Yes.

Q What was the effect of your disallowance on subsequent years?

A None. It was just a rollover adjustment to all the other years.

Q What happened to beginning inventory for each subsequent year?

A Had they been allowed, then the inventory would have increased and decreased according to the figures in 1987.

Q And –

A Which –

Q Sorry.

A Which would have mean that there would be no tax adjustment in subsequent years.

MR. DUNCAN: Your Honor, may I approach the witness?

THE COURT: Yes.

BY MR. DUNCAN:

Q Mr. Machado, I've handed you a stipulated document, a stock purchase agreement. When did you first see this document?

A Around January '94.

Q Okay. And, in what context did you see it?

A I asked the taxpayer to provide documentation for a claimed covenant not to compete expense.

Q Okay. And, they provided you with this document in response?

A Yes.

Q Okay. What did your review of this document indicate?

A That a covenant not to compete was not included in the purchase agreement.

Q Did you pont this out to Mr. Miner?

A Yes, I did.

Q Okay. And how did he respond?

A He told me that there was a written agreement available through his attorney.

Q Okay. When did you next discuss this alleged covenant not to compete with Mr. Miner?

A On March 10th, 1994.

Q Okay. Was anyone else present at this time?

A Mr. Bailey.

Q Okay. Did you ask about the missing covenant at this meeting?

A I did.

Q And what were you told?

A That it was available through their attorney but that he was also preparing a letter in reference to the covenant not to compete.

Q Did you ask again for a copy of the covenant?

A Yes.

Q Did you ever receive a copy of the covenant promised to you?

A No.

Q Did you discuss any further, the matter of the covenant with Mr. Miner?

A Yes, at the closing conference, the matter was brought up again.

Q And, did he provide any copy of a covenant, at that point?

A No, he did not.

Q Okay.

MR. DUNCAN: No further questions, Your Honor.

CROSS-EXAMINATION

BY MR. KELLY:

Q Did you ever call – did you ever call Mr. Zirkle and ask him if there was a covenant?

A Yes, I did.

Q Did he tell you there was an oral covenant?

A He did not respond to my phone call.

Q He did not respond to your phone call?

A No.

Q Did you make a second attempt to determine that?

A No, I did not.

Q Did you ever ask – did you ever ask Mr. Bailey if there was an oral covenant?

A No, I did not.

MR. KELLY: Wait just a minute.

BY MR. KELLY:

Q Did he ever tell you there was an oral covenant?

A At the closing conference, the taxpayer and Mr. Bailey, Mr. Miner, said that there were many verbal agreements as they applied – as they applied to the purchase agreement. Or he just said there was many verbal agreements.

Q Did they tell you there was an oral covenant not to compete?

A No, he did not.

Q Or do you remember?

A In reviewing my notes of the case file, no, they did not.

Q Do you have your notes with you?

A They're contained in the – right there on the table.

Q You have the notes of your closing conference?

A If – they're probably contained in my case file.

Q Well, would you get them, please?

THE COURT: We'll, wait. You can stay there. You used those to refresh your recollection for this testimony today?

THE WITNESS: Yes, sir.

THE COURT: All right. Then those are – Mr. Kelly has a right to review those, under the Rules of Evidence.

MR. DUNCAN: Oh, Your Honor, I would ask –

THE COURT: Do you know what it is that

you're looking for, Mr. Duncan, or do you need the witness' help?

MR. DUNCAN: I would need Mr. Machado's assistance.

THE COURT: All right. Then let's go off the record for a minute and he can find that for you.

MR. DUNCAN: I believe he'd help to quickly find the document.

THE COURT: We'll be off the record for a minute.

(Off record)

THE COURT: So, Mr. Kelly, you have looked at the notes?

MR. KELLY: Yes.

THE COURT: All right. Just fold them up for now.

BY MR. KELLY:

Q One of the things that your notes say is that at the closing conference, the taxpayers did say that although the purchase agreement didn't contain a covenant not to compete, a covenant did exist, isn't that true?

A It says that there were very – there were many verbal agreements.

Q No, I will ask you to read –

A Okay.

Q I will ask you to read your notes prior to that, up higher on the page.

A Do you want me to read the whole thing?

MR. DUNCAN: No objection, Your Honor.

THE COURT: All right.

THE WITNESS: "Per exam, taxpayer claimed that covenant not to compete expense was not reported on original filed return in error. Taxpayer had 10,000 shares of common stock outstanding. Fifty percent interest was

owned, each, by John Miner and Leonard Jasiak. On December 24th.."

MR. KELLY: Your Honor, may I approach? May I approach the witness?

THE COURT: Yes.

MR. KELLY: I don't want to stay here all night.

(Pause)

MR. KELLY: I want you to read starting at line 9 to the Court, please.

THE WITNESS: Okay. "The taxpayer claimed that even though the purchase agreement presented for exam did not specifically state that a covenant clause existed that there was an agreement entered into."

MR. KELLY: I have nothing further.

THE COURT: I'm sorry, and what is the date of that event?

THE WITNESS: Well, this is a summation of my – of my issue, so the closing conference, my notes of my closing conference, I can refer to my work papers.

THE COURT: Well, can you say approximately when the taxpayer said that? You're attributing something to the taxpayer.

THE WITNESS: That was March 29th.

THE COURT: March 29th of –

THE WITNESS: Ninety-four.

THE COURT: Ninety-four, thank you.

BY MR. KELLY:

Q March 29, 1994 is when the taxpayer made that particular statement that's in your notes?

A That's correct.

Q Is that a verbatim quote?

A I would have to look at my work papers to see.

Q Well, do you have your work papers here, too?

A I do.

Q And you think that's in your work papers?

A I think it is.

Q But, in any event, what you recorded here was that the taxpayer told you that even though there wasn't a covenant in the written agreement, a covenant existed, weren't you? Isn't that true?

A. That's true.

Q Thank you.

MR. KELLY: Nothing further.

MR. DUNCAN: No further questions of this witness, Your Honor.

THE COURT: You may step down. Thank you for your testimony.

MR. DUNCAN: I would ask for the opportunity to make a very brief proffer, at which time respondent would have nothing further.

THE COURT: All right. Any objection?

MR. KELLY: No, well, I object but just for the record, Your Honor. I don't –

THE COURT: Well, for the record, this would not be considered by the Court, so long as the proffers from petitioner are not being considered by the Court. Is that the parallel treatment you were concerned about?

MR. KELLY: He can make a proffer, if he wants to, orally from his chair, as far as I'm concerned.

MR. DUNCAN: Your Honor, may we just have a – just a brief, momentary break?

THE COURT: I see your co-counsel is seeking your attention. We'll be off the record for a minute.

(Off record)

MR. DUNCAN: Would you like me to be sworn

in for this or –

THE COURT: It's your proffer. I –

MR. DUNCAN: I would prefer to be sworn.

Whereupon,

JOHN W. DUNCAN,

having been first duly sworn was called as a witness herein, and was examined and testified as follows:

* * *